LEGISLATIVE BUDGET BOARD

Texas State Government Effectiveness and Efficiency Report

Selected Issues and Recommendations

SUBMITTED TO THE 83RD TEXAS LEGISLATURE

PREPARED BY LEGISLATIVE BUDGET BOARD STAFF

JANUARY 2013

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January 2013

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

Ladies and Gentlemen:

I am pleased to submit to the Eighty-third Texas Legislature the fourth edition of the Legislative Budget Board staff report *Texas State Government Effectiveness and Efficiency Report: Selected Issues and Recommendations.* The reports contained herein span the breadth of state government, and provide a wide spectrum of recommendations intended to improve the function of state government. We have prepared the report in compliance with the provisions of Chapter 322 of the Texas Government Code.

Texas has a strong evaluation and audit process, established under the provision of Chapter 322, which provides the Texas Legislature with the information it needs to identify and implement changes that improve state agency organization and operations. The reports, and the resulting statutory and appropriations changes, not only provide for a more fiscally efficient state government, but also improve the effectiveness of state agencies in administering the many programs that carry out the policies they have been directed to execute.

The staff of the Legislative Budget Board prepared the 58 discrete analyses contained in the report with the intention to provide the public with an understanding of the salient findings and concerns related to the issue or program in question, and offer recommendations, if warranted. These analyses also provide the reader with the necessary background and context to fully evaluate a given subject. The full effect of implementing all 137 recommendations would be an estimated positive fiscal impact of $1.9 billion in General Revenue Funds and $2.9 billion in All Funds during the 2014–15 biennium. In addition to these quantifiable fiscal effects, the recommendations would increase the ability of state and local governments to meet their obligations to Texans.

The staff of the Legislative Budget Board appreciates the cooperation and assistance state agencies and institutions of higher education provided during the preparation of this report.

Respectfully submitted,

Ursula Parks
Director

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OVERVIEW OF AFFORDABLE CARE ACT FUNDING AND COSTS IN THE TEXAS STATE BUDGET

The federal Affordable Care Act of 2010 changes the healthcare market in the U.S. Some of these changes have brought and will bring new federal funding to state budgets, while others require additional state funds. This report describes funding received and costs to Texas state agencies and public institutions of higher education as a result of the Affordable Care Act. It details costs and grants from fiscal years 2010 to 2013. It also presents costs and grants identified by state agencies and public institutions of higher education for fiscal years 2014 and 2015. The report does not include effects on other public or private entities, such as hospital districts, individuals, or businesses. It also does not include the additional costs if the state were to expand Medicaid to adults with income below 138 percent of poverty.

FACTS AND FINDINGS

- For fiscal years 2010 to 2013, state agencies and public institutions of higher education will be awarded more than $669 million in federal grants as a result of the Affordable Care Act. Approximately 83 percent of this pays for health insurance or services.
- For fiscal years 2014 to 2015, state agencies and public institutions of higher education expect another $276 million in federal grants from the Affordable Care Act. Most of these funds continue programs and policies from fiscal year 2013.
- State agencies and public institutions of higher education have incurred or anticipate incurring about $101 million in state costs for fiscal years 2010 to 2013. Approximately 63 percent of this expands health services or benefits covered by health insurance. The state cost is offset by savings to General Revenue Funds through coverage of children under the Children's Health Insurance Program and other programs, estimated at approximately $79 million during this period. In addition to the above amounts, they will receive another $318 million in federal grants during this period as match for state expenditures.
- An additional $151 million in state costs for Affordable Care Act requirements have been identified by state agencies and public institutions of higher education for the 2014–15 biennium. The state cost is offset by savings to General Revenue Funds through coverage of children under the Children's Health Insurance Program and other programs, estimated at more than $82 million during this period. In addition to the above amounts, they will receive another $414 million in federal grants during this period as match for state expenditures.

DISCUSSION

Federal funding in the Affordable Care Act (ACA) of 2010 is allocated across a broad array of programs. Various provisions contain funding for new projects or extend funding for reauthorized projects. For example, the law provides new funding to help expand the healthcare workforce and to subsidize retiree health insurance. It also includes funding to assist states in implementing changes to the insurance industry. The law also includes changes required of states that will result in state costs with or without federal matching funds, such as coverage of children up to age 26.

Data were obtained from 2014–15 Legislative Appropriations Requests from state agencies and public institutions of higher education. The information includes actual ACA-related expenditures and grants for fiscal years 2010 and 2011, and estimated amounts for fiscal years 2012 through 2015. Where available, information was updated using federal websites or provided by agencies. The term "cost" is used to refer to instances when additional state funds are required (for example, to draw down federal funds), or when there is a net loss of federal funds. It is in addition to expenditures of additional federal grants without affecting the state General Revenue Fund or other funds of affected agencies.

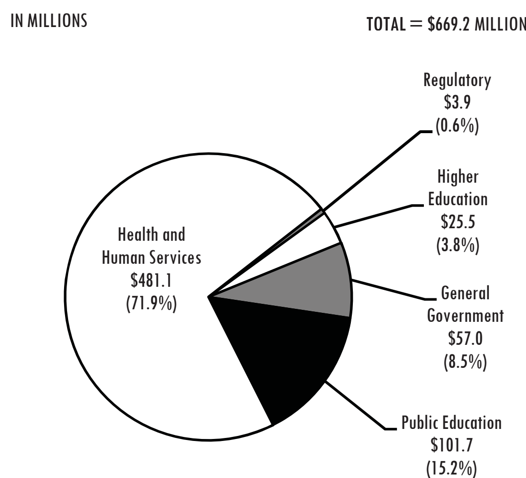
This report only addresses costs and grants to state government. Thus, it does not include effects on other public or private entities, such as hospital districts, individuals, or businesses. For example, additional federal funds to expand federally qualified health centers are not included. The tables may include grants that extend over three to five years. They also include state costs and grants anticipated in fiscal years 2014 and 2015. However, the tables do not include costs associated with full implementation of health insurance exchanges in calendar year 2014.

FEDERAL GRANTS

From March 2010 to September 2013, Texas is estimated to have been granted more than $669 million in ACA funding to state agencies and public institutions of higher education. Much of this is in the form of grants for specific new projects or extensions of existing ones. For the 2014–15 biennium, state agencies and public institutions of higher education expect another $276 million in federal grants from the ACA. For the most part, these grants continue programs and policies from fiscal year 2013. Some of these federal grants result in savings to General Revenue Funds, estimated at just under $80 million during fiscal years 2010 to 2013 and more than $80 million during the 2014–15 biennium.

Figure 1 shows ACA funding granted to Health and Human Services, Public Education, General Government, Higher Education, and Regulatory functions of Texas state government. Health and Human Services agencies received 72 percent, or $481 million in grants awarded to Texas. These include grants to the Health and Human Services Commission (HHSC), the Department of Aging and Disability Services (DADS), and the Department of State Health Services (DSHS). Another $102 million (15 percent) provides grants for Public Education through the Teacher Retirement System (TRS). General Government, through the Employees Retirement System (ERS), received an additional $57 million (9 percent). The remaining $29 million (4 percent) are grants for Higher Education at nine public institutions of higher education, and regulatory functions at the Texas Department of Insurance (TDI).

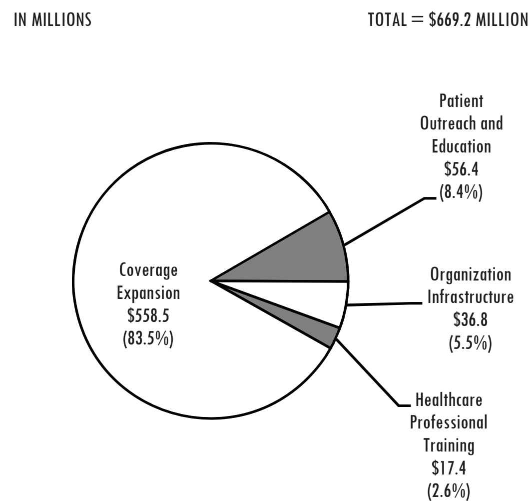
FIGURE 1
AFFORDABLE CARE ACT GRANTS BY STATE GOVERNMENT FUNCTION, FISCAL YEARS 2010 TO 2013



Notes: Reflects total federal grants and estimates through September 2013. Some of the funding is for multiple-year projects. Does not include federal funding that has other associated costs. Total may not sum due to rounding.
Source: Legislative Budget Board.

Figure 2 shows federal ACA grants by purpose of expenditure. Projects vary considerably but can be broadly categorized as expanding healthcare coverage or insurance benefits, providing patient outreach and education, developing organizational infrastructure, or training healthcare professionals. $559 million (83 percent) of the grants to Texas state agencies and public institutions of higher education expand healthcare coverage or insurance benefits. Grants for patient outreach and education comprise the second highest amount of ACA funding, at $56 million (8 percent).

FIGURE 2
AFFORDABLE CARE ACT GRANTS TO STATE AGENCIES AND PUBLIC INSTITUTIONS OF HIGHER EDUCATION, BY PURPOSE OF EXPENDITURE, FISCAL YEARS 2010 TO 2013



Note: Reflects total federal grants and estimates through September 2013. Funding may be used for multiple purposes, but is categorized here in the most prominent grouping. Total may not sum due to rounding.
Source: Legislative Budget Board.

HEALTH AND HUMAN SERVICES

Figure 3 identifies ACA grants to state Health and Human Services agencies. These agencies have been granted $481 million, or 72 percent of all ACA grants. Approximately $392 million is intended to expand healthcare coverage or insurance benefits. Another $54 million is for patient outreach and education to improve personal and public

FIGURE 3
AFFORDABLE CARE ACT GRANTS TO STATE HEALTH AND HUMAN SERVICES AGENCIES
FISCAL YEARS 2010 TO 2013

	FUNDING LEVELS (IN MILLIONS)		USES OF FUNDING		
PROJECT	FEDERAL GRANTS AWARDED/ ANTICIPATED DURING FUNDING PERIOD	EXPENDED OR BUDGETED, FISCAL YEARS 2010 TO 2013	EXPANDING HEALTHCARE COVERAGE OR INSURANCE BENEFITS	PATIENT OUTREACH AND EDUCATION	DEVELOPING ORGANIZATIONAL INFRASTRUCTURE
DEPARTMENT OF AGING AND DISABILITY SERVICES					
Balancing Incentive Program	$301.5	$0.0	X		
Extension of the “Money Follows the Person” Rebalancing Demonstration to promote long-term services and supports in community settings	$3.9	$3.9	X		
Outreach to low income aging or disabled individuals for activities aimed at promoting wellness and preventing disease	$1.8	$1.8		X	
HEALTH AND HUMAN SERVICES COMMISSION					
Teachers’ children’s health insurance to Children’s Health Insurance Program (CHIP) (federal match)	$49.4	$49.4	X		
State-employee Kids Insurance Program (SKIP) to CHIP (federal match)	$23.4	$23.4	X		
Maternal, infant, and early childhood home visiting	$34.9	$24.5		X	
Extension of the “Money Follows the Person” Rebalancing Demonstration to promote long-term services and supports in community settings	$7.9	$7.9	X		
DEPARTMENT OF STATE HEALTH SERVICES					
Transforming Texas: Healthy People to Healthy Communities	$20.0	$19.6			X
Abstinence education	$16.2	$15.9		X	
Providing services to assist adults with a mental health diagnosis and who are receiving Medicaid to live in community settings.	$5.5	$5.5	X		
HIV prevention planning in Dallas	$3.5	$3.5			X
Strengthening integration of chronic disease prevention and health promotions	$2.7	$2.7			X
Detecting and responding to infectious disease outbreaks	$2.7	$2.7			X
Improving quality, effectiveness, and efficiency of public health infrastructure	$2.1	$2.1			X

FIGURE 3 (CONTINUED)
AFFORDABLE CARE ACT GRANTS TO STATE HEALTH AND HUMAN SERVICES AGENCIES
FISCAL YEARS 2010 TO 2013

	FUNDING LEVELS (IN MILLIONS)		USES OF FUNDING		
PROJECT	FEDERAL GRANTS AWARDED/ ANTICIPATED DURING FUNDING PERIOD	EXPENDED OR BUDGETED, FISCAL YEARS 2010 TO 2013	EXPANDING HEALTHCARE COVERAGE OR INSURANCE BENEFITS	PATIENT OUTREACH AND EDUCATION	DEVELOPING ORGANIZATIONAL INFRASTRUCTURE
Texas nutrition, physical activity and obesity	$2.0	$2.0			X
Strengthening public immunization infrastructure	$1.3	$0.6			X
Tobacco cessation	$0.7	$0.7		X	
Behavioral risk factor surveillance	$1.4	$1.4			X
Expanding access to primary care for underserved populations	$0.2	$0.2			X
Total, Fiscal Years 2010 to 2013		**$167.8**	**$90.2**	**$42.9**	**$34.6**
Total Grants During Funding Period	**$481.1**		**$391.7**	**$53.6**	**$35.7**

Notes: Reflects total federal grants and estimates through September 2013. Funding may be used in multiple categories within "Uses of Funding," but is categorized here in the most prominent category. Funding for "Money Follows the Person" at HHSC is net of the amount provided to DADS. "Expended or Budgeted" amounts may include anticipated federal funds not yet granted. Totals may not sum due to rounding.
Source: Legislative Budget Board.

health. The remaining $36 million is being used to develop and improve organizational infrastructure.

DEPARTMENT OF AGING AND DISABILITY SERVICES (DADS)

The largest amount of grants for Health and Human Services agencies went to DADS. DADS received approval to participate in the Balancing Incentive Program. The goal of the program is to increase access to long-term services and supports that are not institutionally based. The state will receive a two-percentage point increase in the federal Medicaid match for non-institutional long-term services and supports. The actual amount received will depend on Texas' expenditures on non-institutional Medicaid long-term services and supports during the program period of performance. Even though the funds are granted to HHSC, DADS has been designated as the state's Balancing Incentive Program implementing agency. The Balancing Incentive Program will free up an estimated $301 million in General Revenue Funds from October 2012 to September 2015. State funds that are freed up must be used for non-institutional Medicaid long-term services and supports. While the primary purpose of the Balancing Incentive Program is to expand services, funds will also be used to develop organizational infrastructure.

The ACA also reauthorizes funding for the "Money Follows the Person" (MFP) rebalancing demonstration through federal fiscal year 2016. This program provides resources and program flexibility to enable elderly and disabled people to live in community settings. The funding is initially granted to HHSC. HHSC then redirects some of the funds to DADS. According to DADS, about 80 percent of MFP grants replace federal Medicaid grants. DADS reports approximately $4 million in MFP grants net of the Medicaid amounts for the 2012–13 biennium. It is likely to continue to receive this funding.

DADS also received approximately $2 million in additional federal grants to expand and enhance outreach and assistance to Medicare beneficiaries with low income and in rural areas. It plans to use these grants for activities aimed at preventing disease and promoting wellness.

HEALTH AND HUMAN SERVICES COMMISSION

ACA changes to the Children's Health Insurance Program (CHIP) provide the most federal grants to HHSC. The ACA expands CHIP coverage to children of state employees and teachers. This partially replaces state General Revenue Funds previously used to insure these children. It provides an additional $73 million in federal grants for fiscal years 2011 to 2013. Coverage under CHIP for children of teachers began September 1, 2010. HHSC estimates a $49 million net savings in General Revenue Funds for the three-year period. It estimates $39 million savings in General Revenue Funds for the 2014–15 biennium. Coverage under CHIP for children of state employees began September 1, 2011. Savings to the General Revenue Fund are a result of reduced costs at ERS, offset by increased costs for state matching funds at HHSC. Only 7,000 of the originally projected 12,000 children of state employees enrolled in CHIP. However, some children could have enrolled in CHIP at a later date without being identified as children of state employees. Thus, savings to the General Revenue Fund could be higher. The policy has become part of the CHIP program, so these savings will continue into the future.

HHSC also received $35 million in grants for the Maternal, Infant, and Early Childhood Home Visiting Program. The program includes home visiting as a primary service delivery strategy. It targets pregnant women and families with children less than five years old. Grants are available to improve maternal and newborn health, reduce child injuries and maltreatment, improve school readiness and academic achievement, reduce crime or domestic violence, improve family self-sufficiency, and improve coordination among resources and supports for families. HHSC received both formula grants and demonstration grants in fiscal years 2011 to 2013. HHSC anticipates receiving an additional $10 million formula grant in fiscal year 2014. Formula grants specify a precise formula for allocating federal funds for a specific purpose. Demonstration grants are usually made to develop a new model to achieve a desired outcome; if successful, it could be adopted by others. States anticipate federal grants through fiscal year 2014.

HHSC also received $8 million in MFP grants in fiscal years 2012–13, net of Medicaid grants the MFP grants replace. This is in addition to the MFP grants transferred to DADS.

Finally, HHSC estimates an increase in Medicaid vendor drug supplemental rebates beginning in fiscal year 2013. These rebates will add to the General Revenue Fund. The ACA increases the federal share of vendor drug supplemental rebates; this results in a total reduction of approximately $35 million in General Revenue Funds for Texas from fiscal years 2010 to 2012. However, HHSC anticipates Medicaid caseload increases and other changes to result in a net increase in Medicaid vendor drug supplemental rebates starting in fiscal year 2013. HHSC estimates the rebates will increase General Revenue Funds by $7.5 million in fiscal year 2013 and $2.3 million for the 2014–15 biennium. This increase is offset by increases in the prescription drug program at HHSC.

DEPARTMENT OF STATE HEALTH SERVICES

DSHS has received 12 grants funded by the ACA, totaling more than $58 million in fiscal years 2010 to 2013. Grants range from less than $1 million to $20 million. It has identified more than $47 million in federal grants for the 2014–15 biennium.

DSHS is receiving more than $5 million per year in grants for abstinence education. DSHS expects this to be available for five years. DSHS is also receiving a transformational grant of $10 million per year for five years. It is being used to implement broad environmental, programmatic, and infrastructure changes to reduce risk factors and prevent chronic diseases. These changes incorporate evidence- and practice-based policy. The grant provides funding to address heart disease and stroke, nutrition and weight, physical activity and fitness, and tobacco use. Because larger communities can apply for this federal grants directly, DSHS provides grants to smaller communities in Texas. The remaining federal grants at DSHS are primarily to develop organizational infrastructure to address a variety of health challenges in the state.

DSHS also estimates cost reductions in some of their programs beginning in fiscal year 2015. DSHS expects an increase in health insurance coverage provided by third-party payers because of the individual mandate required by the ACA. It anticipates the third-party health insurance will pay for some of the services it currently provides. DSHS identifies reductions in:

- infectious disease control, prevention, and treatment;
- health promotion and chronic disease prevention;
- laboratory services;
- primary care and nutrition services;
- behavioral health services;

- community capacity; and
- state-owned and privately owned hospital services.

DSHS expects approximately $12 million lower All Funds costs in fiscal year 2015. It anticipates a nearly $14 million reduction in cost to General Revenue Funds and General Revenue–Dedicated Funds, offset by a $2 million cost increase to Other Funds.

PUBLIC EDUCATION, GENERAL GOVERNMENT, AND REGULATORY FUNCTIONS

Figure 4 identifies ACA grants for Public Education, General Government, and Regulatory functions of Texas state government. They total about $163 million and account for approximately one quarter of all ACA grants. These grants were made to three state agencies: TRS, ERS, and TDI.

TEACHER RETIREMENT SYSTEM AND EMPLOYEES RETIREMENT SYSTEM

Approximately $108 million of the additional federal grants went to TRS and ERS for early retiree reinsurance. The Early Retiree Reinsurance Program provides reimbursements to employment-based health insurance plans for a portion of the cost of covering retirees between the ages of 55 and 64. The funding must be used by insurance plans to reduce or avoid increased costs for premiums and copayments for plan participants. The grants reduce the cost of coverage for members and dependents. It allows these agencies to keep costs of premiums and copayments down for plan participants. Only a limited amount of it reduces the use of General Revenue Funds. In addition, some of it replaces other federal funding that would have been used to pay for the health insurance. The University of Texas System Administration and the Texas A&M University System Administration also received reinsurance payments through this program. In Texas, 124 employers, including TRS, ERS, and the public institutions of higher education received Early Retiree Reinsurance grants totaling $445 million. Employers have until December 31, 2014 to use the funding. No additional funding will be granted after December 31, 2011.

TRS and ERS also plan to revise their prescription drug programs for Medicare-eligible retirees based on a provision

FIGURE 4
AFFORDABLE CARE ACT GRANTS TO STATE PUBLIC EDUCATION, GENERAL GOVERNMENT, AND REGULATORY AGENCIES
FISCAL YEARS 2010 TO 2013

	FUNDING LEVELS (IN MILLIONS)		USES OF FUNDING		
PROJECT	FEDERAL GRANTS AWARDED/ ANTICIPATED DURING FUNDING PERIOD	EXPENDED OR BUDGETED, FISCAL YEARS 2010 TO 2013	EXPANDING HEALTHCARE COVERAGE OR INSURANCE BENEFITS	PATIENT OUTREACH AND EDUCATION	DEVELOPING ORGANIZATIONAL INFRASTRUCTURE
TEACHER RETIREMENT SYSTEM					
Early retiree reinsurance program	$67.7	$67.7	X		
Medicare prescription drug program change	$34.0	$34.0	X		
EMPLOYEES RETIREMENTS SYSTEM OF TEXAS					
Early retiree reinsurance program	$40.0	$40.0	X		
Medicare prescription drug program change	$17.0	$17.0	X		
TEXAS DEPARTMENT OF INSURANCE					
Consumer health assistance program	$2.8	$2.5		X	
Health insurance premium rate reviews	$1.0	$1.0			X
Health insurance exchange planning	$0.1	$0.1			X
Total, Fiscal Years 2010 to 2013	**$162.6**		**$158.7**	**$2.5**	**$1.1**
Total Grants During Funding Period	**--**	**$162.3**	**$158.7**	**$2.8**	**$1.1**

NOTES: Reflects total federal grants and estimates through September 2013. Early retiree reinsurance funding does not net out federal funds that were spent for the insurance benefits. Funding may be used in multiple categories within "Uses of Funding," but is categorized here in the most prominent category. "Expended or Budgeted" amounts may be greater than amounts under "Federal Grant During Funding Period" because the "Expended or Budgeted" amounts may include anticipated federal funds not yet granted.
SOURCE: Legislative Budget Board.

of the ACA. 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 eliminates the donut hole. This change reduces the amount of the subsidy that would come to the two agencies. Consequently, TRS and ERS will no longer take the retiree prescription drug subsidy from Medicare. Instead, TRS and ERS plan to offer a Medicare Part D prescription drug plan. When implemented in January 2013, TRS and ERS estimate increased federal grants in fiscal year 2013 of at least $34 million and $17 million, respectively. Because the program will only operate for eight months in the first fiscal year, federal grants will be greater in fiscal years 2014 and beyond. After fiscal year 2013, TRS and ERS estimate increased federal grants each year of at least $45 million and $24 million, respectively.

TEXAS DEPARTMENT OF INSURANCE

A number of provisions of the ACA affect the insurance market and carriers. TDI received nearly $3 million in a federal grant to educate consumers about their health insurance options and to assist consumers with health insurance enrollment or problems. This funding was available through April 14, 2012. In June 2012, the U.S. Department of Health and Human Services announced additional grants to states for consumer assistance programs. Texas may be eligible for this funding. TDI also received a $1 million federal grant to increase reviews of health insurance premium rates in the state. Rates will be reviewed by the federal government if states do not choose to do so. TDI hired six additional temporary staff to work on the rate reviews. In addition, TDI received a $1 million federal grant for planning a health insurance exchange in Texas. However, after initial analysis by TDI of the feasibility of the state developing and operating an exchange, most of this was returned to the federal government.

PUBLIC INSTITUTIONS OF HIGHER EDUCATION

Figure 5 provides information about funding to nine public institutions of higher education that received ACA grants. The institutions have been granted more than $25 million, and account for approximately 4 percent of all ACA grants. These are primarily in the form of grants to colleges and universities that train healthcare professionals, such as university health science centers. Some of the grants are being used to increase classes, and some are providing student stipends and scholarships. Most of the grants for training healthcare professionals are for multiple years, usually five. Some of the federal grants cover multiple years, indicated under the column "Federal Grants Awarded/Anticipated During Funding Period." It incorporates the amounts in the "expended or budgeted" column.

FIGURE 5
FEDERAL FUNDING AT TEXAS PUBLIC INSTITUTIONS OF HIGHER EDUCATION RESULTING FROM THE AFFORDABLE CARE ACT
FISCAL YEARS 2010 TO 2013

		FUNDING LEVELS (IN MILLIONS)		USES OF FUNDING	
PUBLIC INSTITUTION OF HIGHER EDUCATION	PROJECT	FEDERAL GRANTS AWARDED/ ANTICIPATED DURING FUNDING PERIOD	EXPENDED OR BUDGETED, FISCAL YEARS 2010 TO 2013	EXPANDING HEALTHCARE COVERAGE OR INSURANCE BENEFITS	HEALTHCARE PROFESSIONAL TRAINING
Alamo Community College District/ St. Philip's College	Healthcare professions training of people with low incomes	$2.1	$1.3		X
The University of Texas System Administration	Early Retiree Reinsurance Program	$5.4	$5.4	X	
Texas A&M University System Administration	Early Retiree Reinsurance Program	$2.7	$2.7	X	
Texas Tech University Health Science Center	Expand primary care residencies	$2.9	$0.9		X
	Expand Health and Wellness Center	$5.0	$3.7		X

FIGURE 5 (CONTINUED)
FEDERAL FUNDING AT TEXAS PUBLIC INSTITUTIONS OF HIGHER EDUCATION RESULTING FROM THE AFFORDABLE CARE ACT
FISCAL YEARS 2010 TO 2013

		FUNDING LEVELS (IN MILLIONS)		USES OF FUNDING	
PUBLIC INSTITUTION OF HIGHER EDUCATION	PROJECT	FEDERAL GRANTS AWARDED/ ANTICIPATED DURING FUNDING PERIOD	EXPENDED OR BUDGETED, FISCAL YEARS 2010 TO 2013	EXPANDING HEALTHCARE COVERAGE OR INSURANCE BENEFITS	HEALTHCARE PROFESSIONAL TRAINING
The University of Texas Health Science Center at Houston	Public Health Training Center	$0.6	$0.0		X
The University of Texas Health Science Center at San Antonio	Stipends to expand advance nursing education	$1.4	$0.3		X
The University of Texas Medical Branch	Training of nurse practitioners and nurses, physician assistants, physical therapists, and physicians	$1.5	$0.7		X
The University of Texas Pan American	Scholarships for training physician assistants	$2.0	$0.7		X
The University of Texas Southwestern Medical Center, Dallas	Expand primary care residencies	$1.9	$0.5		X
Total, Fiscal Years 2010 to 2013		**–**	**$16.2**	**$8.1**	**$8.1**
Total Grants During Funding Period		**$25.5**	**–**	**$8.1**	**$17.4**

Notes: Reflects total federal grants and estimates through September 2013. It includes grants that cover up to five years. Grants for early retiree reinsurance do not net out federal funds that were spent for the insurance benefits.
Source: Legislative Budget Board.

The grant to the Alamo Community College District/St. Philip's College is for a demonstration project to train recipients of Temporary Assistance for Needy Families (TANF) and other low income individuals. The training is directed toward well-paying occupations in the healthcare field that are in high demand or experiencing labor shortages. The University of Texas System Administration (UT–System) and The Texas A&M University System Administration (Texas A&M–System) received $5 million and $3 million, respectively, from the Early Retiree Reinsurance Program.

STATE COSTS

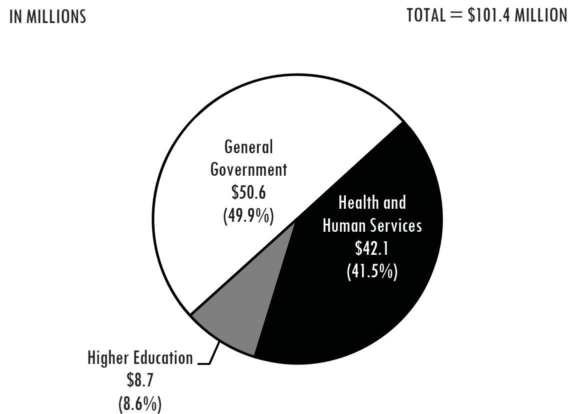
Certain provisions of the ACA require expenditures of non-federal funds. Some of these are used to draw down federal matching funds. When possible, state agencies and public institutions of higher education provided estimates of these costs. Where they could not make estimates, they provided narrative to express concern about an issue. Two state agencies and two public institutions of higher education report increased state costs or reduced state revenues because of the ACA. For fiscal years 2010 to 2013, they report state costs of roughly $101 million. Most of the costs were incurred in fiscal years 2012 and 2013. They are also requesting $151 million in funding for the 2014–15 biennium to cover state costs associated with the ACA.

In addition to the above, state agencies and public institutions of higher education report $318 million in federal grants associated with some of these state funds in fiscal years 2010 to 2013. They anticipate $414 million in additional federal funds for the 2014–15 biennium.

Figure 6 shows the estimated state costs for fiscal years 2010 to 2013 by state government function. General Government (ERS) has a $51 million state cost. Health and Human Services Commission (HHSC) identifies approximately $42 million in state costs through fiscal year 2013. Higher Education entities (two public institutions of higher education) report $9 million in state costs. These are discussed in more detail below.

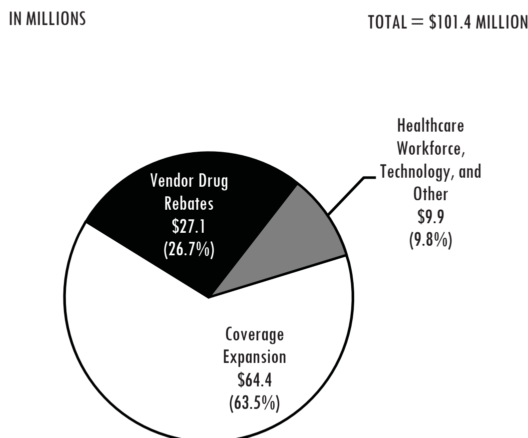
Figure 7 shows state costs by purpose of expenditures for fiscal years 2010 to 2013. Approximately $64 million (63 percent) has been spent for expanding coverage. This includes

FIGURE 6
AFFORDABLE CARE ACT STATE COSTS BY STATE GOVERNMENT FUNCTION, FISCAL YEARS 2010 TO 2013



Source: Legislative Budget Board.

FIGURE 7
AFFORDABLE CARE ACT STATE COSTS TO STATE AGENCIES AND PUBLIC INSTITUTIONS OF HIGHER EDUCATION, BY PURPOSE OF COSTS, FISCAL YEARS 2010 TO 2013



Note: Vendor Drug Program rebates are a reduction in revenues to the state. All other amounts represent increases in costs.
Source: Legislative Budget Board.

expanded insurance and benefits offered through the UT–System, Texas A&M–System, and ERS, as well as the state cost for a primary care physician rate increase at HHSC. Another $27 million (27 percent) reflects the reduction in vendor drug supplemental rebates at HHSC. The remainder is for healthcare workforce development, technology, and other miscellaneous costs.

STATE COSTS TO GENERAL GOVERNMENT AND HEALTH AND HUMAN SERVICES

Figure 8 shows estimated state costs for General Government at ERS and Health and Human Services at HHSC. Agencies report approximately $93 million in state costs for fiscal years 2010 to 2013. Most of these costs will continue into the future. They estimate a state cost of approximately $130 million for the 2014–15 biennium. Part of the costs are in agency baseline requests, and part are in agency exceptional item requests.

EMPLOYEES RETIREMENT SYSTEM

ERS is an employer that provides health insurance to families. As such, it is subject to certain ACA requirements that add costs. The most costly provision for ERS is providing preventive services without cost-sharing. This provision took effect at ERS in fiscal year 2012. ERS estimates the state cost to provide preventive services without cost-sharing at $41 million for fiscal years 2012 and 2013. The state cost at ERS goes up to $55 million for the 2014–15 biennium. The costs at ERS do not include increased or decreased out-of-pocket costs to program participants.

ERS must also provide health insurance coverage for employees' children up to age 26. Before the ACA, it covered children up to age 25. ERS estimates an additional cost to cover children to age 26 at $8 million in state funds for fiscal years 2010 to 2013. ERS estimates this provision to cost the state about $11 million for the 2014–15 biennium.

ERS also estimates a $15 million cost to the state, beginning in fiscal year 2015, to reduce the waiting period to 90 days before providing new employees with health insurance. This cost will continue into the future. It also anticipates a state cost of $35 million for the 2014–15 biennium for a transitional reinsurance fee. This fee is assessed on plans to help stabilize the health insurance market when health insurance exchanges become operational. The fee continues through fiscal year 2016.

HEALTH AND HUMAN SERVICES COMMISSION

HHSC is experiencing additional state costs and reduced federal revenues as a result of the ACA. The largest of these is a $27 million reduction in supplemental rebate revenues in the Vendor Drug Program within Medicaid from fiscal year 2010 to 2013. The ACA increases the amount of rebates from pharmaceutical manufacturers that go to the federal government, causing a reduction to the state from fiscal years 2010 to 2012. HHSC reports an increase in rebates going to

FIGURE 8
STATE COSTS AT THE EMPLOYEES RETIREMENT SYSTEM AND HEALTH AND HUMAN SERVICES COMMISSION RESULTING FROM THE AFFORDABLE CARE ACT, FISCAL YEARS 2010 TO 2015

	USES OF FUNDING			STATE COSTS OR REVENUE REDUCTIONS (IN MILLIONS)			
				FISCAL YEARS 2010 TO 2013		FISCAL YEARS 2014 TO 2015	
PROJECT OR AFFORDABLE CARE ACT PROVISION	COVERAGE EXPANSION	VENDOR DRUG REBATES	TECHNOLOGY AND OTHER	STATE COSTS	TOTAL FUNDS	STATE COSTS	TOTAL FUNDS
EMPLOYEES RETIREMENT SYSTEM							
Provide preventive services with no cost sharing	X			$41.4	$51.1	$55.1	$68.0
Provide coverage for dependents up to 26 years old	X			$8.3	$10.2	$11.5	$14.2
Eliminate lifetime maximum for out-of-network services	X			$0.5	$0.6	$0.4	$0.5
Patient Centered Outcomes Research Fee			X	$0.4	$0.5	$1.4	$1.8
Transitional reinsurance fee			X	$0.0	$0.0	$35.3	$43.5
90-day wait period	X			$0.0	$0.0	$15.5	$19.1
HEALTH AND HUMAN SERVICES COMMISSION							
Vendor Drug Program rebates		X		$27.1	$27.1	$0.0	$0.0
Automated Systems Modifications			X	$8.5	$58.1	$2.8	$21.5
Primary care physician rate increase	X			$5.0	$259.4	$7.2	$372.6
Tobacco cessation for pregnant women and teens in Medicaid and CHIP	X			$0.3	$0.8	$0.3	$0.7
Curative treatment of children in Medicaid electing hospice	X			$0.3	$0.8	$0.1	$0.5
Consulting services for healthcare reform			X	$0.8	$2.0	$0.8	$2.0
Total Costs Identified by State Agencies				**$92.7**	**$410.6**	**$130.4**	**$544.4**

NOTES: Total funds do not include funds outside of the state treasury. Vendor Drug Program rebates are a reduction in revenues to the state. All other amounts represent increases in state costs. The state costs for tobacco cessation activities for pregnant women at HHSC do not reflect a one percentage point increase in the federal match rate. Part of the costs for the 2014–15 biennium are included in agency baseline requests, and part are added as exceptional items. Totals may not sum due to rounding.
SOURCE: Legislative Budget Board.

General Revenue Funds from fiscal years 2013 to 2015, due to several factors. This will be offset by an increase in the cost of the Vendor Drug Program at HHSC.

HHSC will also have state costs associated with modifying computer hardware and software. This is in preparation for anticipated increases in Medicaid caseloads, and connecting with a health insurance exchange by January 2014. This is part of a larger eligibility system modernization project, which includes migration of the CHIP eligibility determination process from a contractor's system to the Texas Integrated Eligibility Redesign System (TIERS) at HHSC. The part of the project that relates to the ACA will have a federal match of 90 percent for development and 75 percent for operations. For fiscal years 2012–2013, HHSC estimates a cost related to ACA requirements of $8.5 million in General Revenue Funds. HHSC estimates a cost of $2.8 million in General Revenue Funds during the 2014–15 biennium. HHSC anticipates the project will be completed by December 2013. Because some of the modifications had been planned, the higher federal match may allow more work with the same amount of General Revenue Funds. HHSC did not require additional appropriations for this project. For more information, see the report entitled *Identify State Costs Related to Determining Client Eligibility for Entitlement Programs* (page 125).

In addition, HHSC expects a $5 million cost to the state in fiscal year 2013, rising to $7 million in the 2014–15 biennium to increase rates for primary care services provided

by primary care physicians. The rate increase begins on January 1, 2013 and continues to the end of calendar year 2014. The Federal match is 100 percent for the rate above the rate in effect in July 2009. Because Texas lowered its rates after this date, General Revenue Funds costs will increase to comply with this requirement. The 100 percent federal funding for this rate increase ends after calendar year 2014. HHSC anticipates pressure to continue funding these services at the higher rates after 2015. It believes a drop in rates could result in challenges to maintaining an adequate network of physicians. HHSC would also like to provide the same funding to other physicians that provide the same services. These would also require additional General Revenue Funds. HHSC has included exceptional items in its Legislative Appropriations Request for this.

Figure 8 does not include the costs to expand Medicaid to all children between 100 percent and 138 percent of the federal poverty level. HHSC identified this ACA requirement in their Legislative Appropriations Request but did not provide any cost estimates. These children may have previously been covered by CHIP.

STATE COSTS TO PUBLIC INSTITUTIONS OF HIGHER EDUCATION

Figure 9 provides information from the two public institutions of higher education that will have additional state costs relating to the ACA from fiscal years 2012 to 2015. They did not report state costs due to the ACA before fiscal year 2012. They anticipate $9 million in state costs in fiscal years 2012 and 2013 and $21 million for the 2014–15 biennium.

The ACA requires certain health insurance carriers to provide preventive services with no deductibles, copayments, or coinsurance. The UT-System and the Texas A&M-System, as employers that provide health insurance to families, have implemented this provision. Unless premiums are raised to cover the increase to the health insurance plans, the cost to the systems will increase. They estimate this at more than $5 million in state costs for fiscal years 2012 and 2013. The systems estimate state costs of about $8 million for the 2014–15 biennium. These costs will continue into the future.

Both systems must insure employees' children up to age 26 as a result of the ACA. Before the ACA, they covered children up to age 25. The two systems report state costs of more than $3 million for fiscal years 2012 and 2013. They estimate state

FIGURE 9
COSTS AT TEXAS PUBLIC INSTITUTIONS OF HIGHER EDUCATION RESULTING FROM THE AFFORDABLE CARE ACT, FISCAL YEARS 2012 TO 2015

	USES OF FUNDING		STATE COSTS (IN MILLIONS)			
			FISCAL YEARS 2012 TO 2013		FISCAL YEARS 2014 TO 2015	
PROJECT OR AFFORDABLE CARE ACT PROVISION	COVERAGE EXPANSION	HEALTHCARE WORKFORCE AND OTHER	STATE COSTS	TOTAL FUNDS	STATE COSTS	TOTAL FUNDS
THE UNIVERSITY OF TEXAS SYSTEM ADMINISTRATION						
Provide preventive services with no cost sharing	X		$2.6	$2.6	$4.1	$4.1
Provide coverage for dependents up to 26 years old	X		$0.8	$0.8	$1.2	$1.2
Patient Centered Outcomes Research Fee		X	$0.0	$0.0	$0.2	$0.2
90-day wait period	X		$0.0	$0.0	$2.6	$2.6
Transitional reinsurance fee		X	$0.0	$0.0	$4.0	$4.0
Loss of FICA exclusions		X	$0.0	$0.0	$0.8	$0.8
TEXAS A&M UNIVERSITY SYSTEM ADMINISTRATION						
Provide preventive services with no cost sharing	X		$2.7	$2.7	$4.0	$4.0
Provide coverage for dependents up to 26 years old	X		$2.5	$2.5	$3.5	$3.5
Loss of FICA exclusions		X	$0.1	$0.1	$0.3	$0.3
Patient Centered Outcomes Research Fee		X	$0.0	$0.0	$0.1	$0.1
Total Costs Identified by Public Institutions of Higher Education			**$8.7**	**$8.7**	**$20.8**	**$20.8**

Source: Legislative Budget Board.

costs of about $5 million for the 2014–15 biennium. These costs will continue into the future.

The systems also identify costs associated with changes that will result in lower amounts being contributed to flexible health spending accounts. With lower levels of "before tax" earned income set aside, employees will have a higher taxable wage. Since the systems pay part of the Federal Insurance Contributions Act (FICA) taxes on taxable earnings, the ACA changes increase their costs slightly in fiscal years 2012 and 2013. The costs increase to about $1 million for the 2014–15 biennium. These costs will continue into the future.

The UT-System anticipates a transitional reinsurance fee required under the ACA. It estimates a state cost of about $4 million for the 2014–15 biennium. This fee continues through fiscal year 2016.

The UT-System also anticipates a cost to reduce the waiting period for providing new employees with health insurance. This change begins in fiscal year 2015. The ACA requires the waiting period to be no longer than 90 days. The system anticipates the change will add about $3 million per year in state costs.

COSTS OUTSIDE THE STATE TREASURY

TRS and two public institutions of higher education estimate an additional $95 million in costs outside the state treasury to implement the ACA between fiscal years 2010 and 2013. This increases to about $126 million for the 2014–15 biennium.

TRS estimates a $58 million cost to provide preventive services without employee cost-sharing for fiscal years 2012 and 2013. It anticipates an additional cost of $70 million for the 2014–15 biennium. It also anticipates $22 million for fiscal years 2012 and 2013 and about $26 million for fiscal years 2014 and 2015 to expand coverage to employees' children up to age 26. While not directly affecting General Revenue Funds at TRS, the higher costs to the TRS Trust Fund could affect its future actuarial soundness.

The UT-System also identifies approximately $10 million in costs outside the state treasury to provide preventive services without employee cost-sharing and to expand coverage to employees' children up to age 26 in fiscal years 2012 and 2013. These and other costs outside the state treasury rise to $26 million for the 2014–15 biennium.

The University of Texas Health Science Center at San Antonio (UTHSC-San Antonio) also reports approximately $5 million for ACA-related costs outside the state treasury for fiscal years 2011 to 2013. The funds will be used to develop and achieve meaningful use in exchanging health information, to convert to new disease and procedure coding under the International Coding of Diseases system, and to develop clinical nursing. UTHSC-San Antonio anticipates a continuing cost of approximately $2 million per year.

OTHER CONCERNS OF PUBLIC INSTITUTIONS OF HIGHER EDUCATION

In addition, public institutions of higher education identified three areas needing additional funding. However, they did not specify the cost. First, those that train healthcare professionals highlighted the need to expand capacity of the healthcare system. Their concerns focus primarily on the need for more healthcare professionals. This is to accommodate the considerable increase in the number of people who will have health insurance coverage as a result of the ACA. The ACA focuses on primary care, so the institutions mention a need to train more primary care physicians and nurses. However, they are concerned about the low number of Graduate Medical Education slots available at their institutions and in Texas. One institution suggests increasing the class size and building more classes for undergraduate medical students. The public institutions of higher education also express concerns about the shortage of dentists, laboratory technicians, public health workers, allied health professions, and clinical informatics physicians. An informatics physician is a doctor who can decide what data are most useful in clinical decision-making, and the most efficient ways for data to be delivered and used by physicians. UTHSC-San Antonio estimates ongoing costs for a clinical informatics physician will be $180,000 annually.

The second challenging area is that public institutions of higher education that provide clinical services to patients on Medicare must meet new Health Information Technology (HIT) standards. The public institutions of higher education are concerned about the costs to develop, implement, and use electronic medical records. They indicate that the installation of HIT will be costly. It requires significant equipment upgrades and additional faculty, employees, training, and maintenance. Only some of the cost would be offset by Medicare incentive payments. Those not reaching the Medicare standards will not be eligible for incentive payments and their Medicare payments will decline.

Finally, public institutions of higher education that provide clinical services anticipate significant changes in the payer

mix for patients seen in their practices. According to one institution, this is a result of the expansion of Medicaid and less expensive alternatives offered through health insurance exchanges. They believe Medicaid payments will not cover their costs, resulting in significant shortfall in revenues. This is likely even after the Supreme Court ruling made Medicaid expansion optional, since HHSC expects growth in Medicaid caseloads without the expansion. The institution also predicts shortfalls due to low payments from insurance purchased through health insurance exchanges.

MEDICAID EXPANSION TO ADULTS

Beginning in January 2014, the ACA provides enhanced FMAP for states to provide Medicaid coverage of adults with income below 138 percent of poverty. In calendar years 2014 to 2016, the FMAP for services for these adults is 100 percent, declining to 90 percent by calendar years 2020 and beyond. However, administrative costs remain at a 50 percent FMAP for all years. Thus, if the state were to choose this option, some state funding would be required in all years. HHSC provides analysis of state costs and persons served. It can be accessed on-line at http://www.hhsc.state.tx.us/news/presentations/2012/080112-Senate-HHS-ACA-Presentation.pdf.

CONCLUSION

Thus far, the ACA has provided federal grants and added state costs to state agencies and public institutions of higher education. Some of the funding will continue into the future. Additional federal grants may become available as well.

Most of the costs identified thus far will continue into the future. Any expansion of Medicaid would entail additional costs to the state. A number of other provisions in the ACA that will be implemented in the future would also result in additional costs to the state.

Loss of federal funding to continue rate increases for primary care physicians could present challenges in maintaining an adequate network of physicians. HHSC is concerned that the primary care physicians will drop out of the Medicaid program once the full federal funding ends at the end of calendar year 2015, unless HHSC is able to maintain the higher rates. HHSC would also like to provide the same funding to other physicians that provide the same services. This would also require additional General Revenue Funds. This will add pressures to General Revenue Funds.

HHSC also plans to expand its automated system to handle a higher Medicaid caseload and connect with the federally operated health insurance exchange. While most of the cost is expected to be paid with Federal Funds, there will be a cost to General Revenue Funds.

Finally, some of the additional costs resulting from the ACA pays for preventive services. However, any savings resulting from early detection and treatment are not identified. These savings might also mitigate costs to General Revenue Funds.

IMPROVE FUTURE SIGNIFICANT FEDERAL FUNDS AND STIMULUS OVERSIGHT

In February 2009, the U.S. Congress passed and the President signed the American Recovery and Reinvestment Act. This legislation was an economic stimulus program that included $787 billion in federal aid and tax cuts. Many states used these funds to address budget gaps. In July 2009, the National Governors Association estimated states faced budget gaps from $200 billion to $250 billion through fiscal year 2011.

This report describes how the State of Texas managed economic stimulus funds. In general, oversight officials found few significant issues with how the state administered programs, and stimulus funds were expended in a timely manner. New, large awards, however, posed challenges. Some existing programs such as the Weatherization Assistance Program increased greatly. All agencies that received funds dealt with new federal rules. In Texas, state administration of the $24.6 billion in economic stimulus funds was de-centralized. No single authority administered programs or set procedures. Instead, multiple agencies had oversight. There were also some program delays and inefficiencies. By designating a single coordinator to administer any future federal stimulus funds, the state could improve how it reports, monitors, and manages federal funds.

FACTS AND FINDINGS

- ♦ Texas state agencies and public institutions of higher education reported $24.6 billion in economic stimulus funds, as of September 9, 2012. As of that date, they spent 95 percent of the funds.
- ♦ Texas received $29.6 billion in economic stimulus funds. This includes state and local governments, non-profits, and private companies.
- ♦ Oversight officials found few significant problems with how state agencies managed economic stimulus funds.

CONCERNS

- ♦ Federal and state reporting requirements for the American Recovery and Reinvestment Act were redundant, which increased agencies' workloads.
- ♦ In Texas, American Recovery and Reinvestment Act administration was de-centralized. There was no single entity that administered programs or set procedures.
- ♦ A few stimulus-related programs had implementation challenges that led to program delays and inefficiencies.

RECOMMENDATION

- ♦ **Recommendation 1:** Include a rider in the introduced 2014–15 General Appropriations Bill to direct the Comptroller of Public Accounts to set state reporting standards and procedures, including performance benchmarks, if the state receives federal stimulus funds or other large, significant awards outside the usual federal appropriations process.

DISCUSSION

In February 2009, the U.S. Congress passed and the President signed the American Recovery and Reinvestment Act (ARRA). Many states used these funds to fill budget gaps. In July 2009, the National Governors Association (NGA) estimated states faced budget gaps from $200 billion to $250 billion through fiscal year 2011. ARRA was intended to improve the national economy. The Congressional Budget Office (CBO) first estimated the legislation would cost $787 billion; CBO later revised its estimate to $831 billion. States received federal funds for education, transportation, healthcare, and energy programs as one-time awards.

In Texas, the Eighty-first Legislature, Regular Session, 2009 appropriated $14.4 billion in Federal Funds through House Bill 4586 and Article XII of the General Appropriations Act (GAA). Texas received more awards later, including many that are typically excluded from the budget. As of September 9, 2012, state agencies and IHEs received $24.6 billion in ARRA Federal Funds, according to the Comptroller of Public Accounts (CPA). Overall, Texas received approximately $30 billion, which included awards to state and local governments, non-profits, and private companies.

As **Figure 1** shows, the five largest awards in the 2010–11 GAA totaled $11.5 billion. These awards include: Texas Medicaid Program, State Fiscal Stabilization Fund-Education, Highway Planning and Construction, Title I Grants to Local Education Agencies, and Special Education Grants (IDEA Part B). By September 2012, agencies reported

FIGURE 1
FIVE LARGEST ARRA AWARDS IN THE 2010–11 GENERAL APPROPRIATIONS ACT AND REPORTED AWARD AMOUNT, SEPTEMBER 2012

(IN MILLIONS)

AWARD	STATE AGENCY	INITIAL APPROPRIATION	REPORTED AWARD AMOUNT
Texas Medicaid Program	Health and Human Services Commission	$4,098.8	$5,864.7
State Fiscal Stabilization Fund-Education	Texas Education Agency	$3,250.2	$3,250.3
Highway Planning and Construction	Texas Department of Transportation	$2,250.0	$2,240.5
Title I Grants to Local Education Agencies	Texas Education Agency	$944.6	$948.7
Special Education Grants (IDEA Part B)	Texas Education Agency	$945.6	$945.6
	TOTAL	$11,489.2	$13,249.9

NOTES: Initial appropriation includes House Bill 4586 and Senate Bill 1. Includes Medicaid awards within the General Appropriations Act. Texas's Medicaid award increased due to a higher Federal Medical Assistance Percentage (FMAP). Congress also extended the increased FMAP for two additional quarters.
SOURCES: Legislative Budget Board; Comptroller of Public Accounts; Health and Human Services Commission.

these five awards totaled $13.2 billion. The largest award not included in the 2010–11 GAA was Unemployment Insurance-Direct Payments. In addition, ARRA funds paid for appliance rebates, child support, tax credits, broadband, senior services, work-study, and other programs.

Most ARRA awards were required to be spent within two to three years after agencies received notice of their awards. This meant most agencies had to spend funds by the end of fiscal year 2012. The few awards that may continue into the 2014–15 biennium include Highway Planning and Construction, High-Speed Rail Corridors and Intercity Passenger Rail Service-Capital Assistance Grants, and debt service on Build America Bonds (BABs). Highway funds expire in September 2015. Since September 2010, de-obligated highway funds may be spent on cost overruns for current projects. High-Speed Rail Corridors and Intercity Passenger Rail Service Grants-Capital Assistance Grants must be spent by September 2017. The Texas Department of Transportation received $15 million to study high-speed rail service from Dallas-Fort Worth to Houston. As of September 2012, the agency had not spent any of this award. The U.S. Department of the Treasury pays debt service subsidies on BABs for their lifespan.

REPORTING AND MONITORING

No single state entity monitored how ARRA funds were managed, allocated, or expended. Rather, state agencies reported to many state and federal entities. During the Eighty-first Legislature, Regular Session, 2009, the Select Committee on Federal Economic Stabilization Funding was formed to provide oversight. Subsequently, House Bill 2942 was introduced to form the Texas Fiscal Responsibility Office and Recovery Act Accountability Board. The Texas Legislature did not pass the bill. The committee made its final report in December 2010, and it did not re-form for the Eighty-second legislative session.

Agencies that received ARRA funds submitted quarterly reports to the Office of the Governor, Legislative Budget Board (LBB), State Auditor's Office (SAO), and CPA. LBB staff developed an online tool to collect and analyze these reports. These reports included: federal agency; program; amount; project description(s); expenditures and obligations; and job estimates. In January 2010, LBB staff began to collect this data. LBB staff shared reports with the Office of the Governor, SAO, CPA, and Texas Legislature. LBB staff also posted the reports on its website.

Agencies also filed weekly reports to CPA, which published the reports on its Window on State Government website. It showed county data, grant and loan offerings, and other details. CPA also trained other agencies how to report data, the U.S. Government Accountability Office (GAO) noted. The State Agency Internal Audit Forum also offered accounting and transparency training. The Office of the Governor, meanwhile, formed a Stimulus Working Group that included agency representatives.

Agencies and IHEs that received State Fiscal Stabilization Fund-Government Services funds filed monthly reports with the Texas Higher Education Coordinating Board (THECB). THECB managed this $723.2 million award, which primarily paid for salaries and other higher education costs. TEA, meanwhile, oversaw many large public education programs. Local education agencies filed expenditure reports

to TEA through an existing reporting system and submitted job figures each quarter.

In addition to state reports, agencies filed quarterly reports with the federal government. If an agency received an award of $25,000 or more, it filed a Section 1512 report by using the FederalReporting.gov website. ARRA exempted programs such as Medicaid and Unemployment Insurance from these reports. The public could search this information at Recovery.gov, a federal website intended to make ARRA spending transparent.

LBB QUARTERLY REPORTS

While most agencies easily complied with LBB reports, there were some early challenges. The federal Office of Management and Budget (OMB), for example, changed reporting requirements for job figures. During the first reporting period, recipients reported jobs cumulatively, and they also determined if a job was "created" or "retained." In December 2009, OMB said this calculation was subjective and requested one number from recipients: jobs funded by ARRA. It requested that recipients report jobs as full-time equivalents on a quarterly, non-cumulative basis. As a result, LBB staff spoke with agencies and IHEs to ensure they followed the new rules.

Agencies had to master many reporting systems, which required a high learning curve. After a few cycles, agencies better understood state and federal rules. LBB staff did not have to follow up as often. At the federal level, authorities saw progress. GAO, for instance, noted how jobs data for the Weatherization Assistance Program (WAP) "improved over time." This was true also of quarterly reports sent to the LBB.

QUALITY CONTROL

Multiple state and federal agencies monitored ARRA spending. ARRA put in place new reporting systems, and federal agencies set reporting standards. These changed, however, especially during the first reporting cycles. As a result, state officials watched for updates and new rules. It was an iterative process. It required state agencies to be flexible and responsive to changes.

Communication improved quality control. LBB staff regularly shared collected data with other key state oversight agencies, including CPA, SAO, Office of the Governor, and THECB. In addition, these entities often compared their records to others. Conversations between agencies encouraged accuracy. Agencies could confirm information and find errors more easily. When state officials saw discrepancies, they contacted agencies to address any concern.

As GAO observed, CPA "took steps to help ensure that Texas agencies and institutions reported information accurately." The agency developed inventory, accounting, and database systems. It also developed a transparency website that featured federal and state reports.

SAO also held agencies accountable. From March 2010 to February 2012, it published 15 ARRA-related reports, which included three Statewide Single Audits. SAO also reviewed transportation, water, research and development, financial aid, and workforce programs that used ARRA funds. The agency added staff to assist this process.

From April 2009 to September 2010, GAO published seven bi-monthly reviews of Texas's ARRA spending. GAO evaluated programs, fund use, impact, transparency, and accountability. It found few critical problems, but it cited concern about the Weatherization Assistance Program (WAP). The Texas Department of Housing and Community Affairs (TDHCA) administered this program. Its annual WAP budget is usually $13 million. Its ARRA award was $327 million. GAO cited spending, internal control, and monitoring issues. GAO noted many states had issues with the WAP. For more information, see *Improve Weatherization Assistance Program and Expanded Federal Programs* (page 28).

POSITIVE OUTCOMES

Texas was a top recipient of ARRA funds. Despite the fact agencies received nearly $25 billion in Federal Funds, there were few controversies. Many states that received fewer funds received greater negative feedback from oversight officials. With few exceptions, Texas agencies administered programs well. For instance, agencies with large programs expended most of their awards. As **Figure 2** shows, the five agencies that received the most ARRA funds had low unexpended balances by September 2012.

ARRA also contributed to an increased focus on making government spending more transparent. In February 2012, *Governing* reported that ARRA did "more to promote transparency at almost all levels of government than any piece of legislation in recent memory." In fact, Congress is considering a transparency bill using the ARRA model. The Digital Accountability and Transparency Act (DATA) requires states to file quarterly reports for all federal funds. The U.S. House of Representatives unanimously passed its version in April 2012. To date, the bill had not become law.

FIGURE 2
AGENCIES WITH HIGHEST ARRA EXPENDITURES, SEPTEMBER 2012

(IN MILLIONS) AGENCY	TOTAL AWARDED AMOUNT	EXPENDED AMOUNT	PERCENTAGE EXPENDED
Health and Human Services Commission	$6,764.3	$6,449.2	95%
Texas Education Agency	$6,381.2	$6,127.4	96%
Texas Department of Transportation	$2,479.4	$2,197.3	89%
Texas Department of Housing and Community Affairs	$1,159.0	$1,154.9	100%
Texas Higher Education Coordinating Board	$723.2	$723.2	100%

Note: Includes awards within the General Appropriations Act.
Sources: Legislative Budget Board; Comptroller of Public Accounts; Health and Human Services Commission.

IMPLEMENTATION CHALLENGES

A few agencies had challenges implementing programs. The Texas Trade Up Appliance Rebate Program, administered by CPA, received criticism after a reservation system crashed. According to *The Dallas Morning News*, the website received more than 38 million visits in one day, while a call center received 1,000 phone calls per minute. The Comptroller of Public Accounts, in a statement, noted problems with a third-party vendor. The vendor claimed it was a cyber-attack victim.

Another program that drew attention was the WAP. TDHCA did not weatherize one home until October 2009, seven months after it received its award notice, officials told LBB staff. There were many reasons for the delay. The U.S. Department of Labor had to set wage rates; before, the WAP was exempt. The agency also had to expand its provider network. Other states had difficulties. For example, Delaware suspended its WAP for months due to "waste and possible corruption," *The News Journal* reported. Even though TDHCA eventually surpassed its goals, its slow start led observers to voice concern.

CONSIDERATIONS AND RECOMMENDATION

While Texas has expended most ARRA funds, some economists and federal officials have called for more stimulus. As mentioned before, Congress may require state agencies to file quarterly reports for all federal funds. Agencies should be ready if federal programs expand or reporting rules change. There are several lessons that can be learned from ARRA administration in Texas.

First, the Texas Legislature may want to consider a centralized system for the administration of future stimulus funding. Recommendation 1 would include a rider in the introduced 2014–15 General Appropriations Bill to direct the CPA to set state reporting standards and timelines, including performance benchmarks, if ten or more state agencies receive a combined total greater than or equal to $1 billion in federal stimulus funds, or other one-time allocations, appropriated through legislation separate from the annual federal appropriations bills. The CPA would align these standards and reports to any related federal reporting requirements.

The CPA could reduce duplication of efforts by streamlining reports and procedures across agencies. In addition, the agency could develop performance benchmarks that set clear, measurable program expectations and goals.

In light of ARRA, the NGA observed states usually had one authority to offer a "broad perspective and ability to coordinate funding across stove-piped federal programs." State officials, however, told GAO Texas uses a decentralized model dealing with the federal government, which allows state agencies to develop their own relationships with federal agencies. The Office of the Governor formed a working group, but several agencies had oversight and collected data, and each had its own reporting system. State agencies had to report data to oversight agencies in similar but distinct ways. The NGA told the legislative and executive branches to "avoid duplicative or unnecessary reporting requirements by sharing information and developing common definitions to make state reporting easier." Oversight coordination would also "avoid duplication and minimize the impact on limited state resources." Although directed to the federal government, this makes sense for states too.

Another lesson from ARRA is agencies must set clear expectations. During the process, communication was commendable. There were moments, though, when policies or plans were not clearly explained. CPA officials, for instance, knew demand for appliance rebates exceeded supply. The agency considered but rejected a lottery to

distribute the rebates. It is unclear whether Texans who wanted a rebate knew how limited supply was. In retrospect, a lottery might have set a better expectation because it implies a limited supply, while an open reservation system does not.

It is also important agencies communicate timeframes judiciously. The NGA cautioned Congress that "spending money quickly must be tempered with the objective of spending federal taxpayer dollars wisely." In committee hearings, TDHCA officials received negative feedback about the WAP. Observers expected money to move faster. In public, the agency mentioned wage and other issues. In hindsight, it might have lowered expectations and stressed it would meet its goal, but needed more time for setup.

TDHCA faced many of the same obstacles as other WAP operators. As **Figure 3** shows, operators reported many of the same issues to GAO. The most common was meeting production targets. Other common issues were meeting reporting requirements and not having enough staff.

FISCAL IMPACT OF THE RECOMMENDATION

The recommendation is expected to have no significant fiscal impact to the state. It is assumed the state could absorb the cost of the designated coordinator within existing state resources.

The introduced 2014–15 General Appropriations Bill includes a rider to implement Recommendation 1.

FIGURE 3
WEATHERIZATION ASSISTANCE PROGRAM RECIPIENTS NATIONWIDE THAT REPORTED THESE CHALLENGES DURING FIRST PROGRAM YEAR
APRIL 1, 2009 TO MARCH 31, 2010

SELECT CHALLENGES	PERCENTAGE OF RECIPIENTS
Balancing the requirements to meet production targets and to ensure work is done correctly	91%
Meeting production targets	91%
Having additional reporting requirements	90%
Implementing new program requirements that were developed as program progressed	89%
Implementing Davis-Bacon requirements	88%
Adjusting to changes in existing reporting requirements	87%
Meeting federal reporting requirements	84%
Having too few monitoring staff	81%
Having insufficient administrative staff	76%
Having additional reporting requirements for monitoring	75%

Sources: Legislative Budget Board; Government Accountability Office.

EXPAND THE USE OF THE SYSTEM BENEFIT FUND TO SUPPORT ENERGY-RELATED PROJECTS

Revenue for the System Benefit Fund is generated through an electricity usage fee for customers in deregulated areas of Texas. Revenue collected from this charge is expended primarily on providing discounts on electric utility bills to qualifying low-income populations. These discounts may range from 10 percent to 20 percent. Texas allocates funds differently than most other states that have a similar charge. Other states allocate funds to directly support low-income utility discount programs. However, many states also allocate funds to additional programs that have secondary public benefits; such as weatherization, energy efficiency and renewable energy.

Supporting these additional programs provides an ongoing benefit to recipients and the public. Studies show that the benefits of energy efficiency can be greater than the subsidy the low-income discount program has been able to provide. Weatherization and energy efficiency measures also contribute to providing local economic impact. This impact is accomplished by supporting jobs in these industries, as well as reducing energy consumption and, thereby, marginally reducing air pollution.

Credit-enhancement programs assist in providing low-interest loans and other financing terms that benefit a particular sector of the economy. Implementing a program such as this for energy-related projects would provide an additional benefit to low-income populations and provide a means of reducing the current balance in the System Benefit Fund account. The state would increase its ability to assist entities in increasing access to the necessary capital required for modern energy investment. Prioritizing this program for loans that benefit low-income populations remains consistent with the System Benefit Fund. Energy efficiency benefits obtained could reduce consumer utility bills.

FACTS AND FINDINGS

- ♦ Texas allocates System Benefit Fund monies almost exclusively for subsidizing low-income electric utility bills. Other methods, such as supporting energy efficiency initiatives, have additional public benefits.
- ♦ The average annual net benefit of the low-income discount program in fiscal year 2011 was approximately $60 per eligible utility customer. The estimated benefit of those receiving weatherization services is approximately $400 per household annually.
- ♦ Revenue from the System Benefit Fund fee regularly exceeds appropriations made out of the account. The balance in the account has been used for state budget certification purposes. The Comptroller of Public Accounts has estimated the available balance at the end of the 2012–13 biennium to be approximately $851 million.
- ♦ Several states have capitalized credit enhancement or other loan programs to supply capital for energy efficiency and clean energy investments. These projects can also have a direct benefit to low-income populations by reducing current or future utility expenses. Reducing expenses can be accomplished by incorporating more effective energy management technology into new construction or renovation projects.

CONCERNS

- ♦ Several different strategies for providing assistance to low-income electricity customers are authorized in statute. Allocations from the System Benefit Fund, however, have primarily been for the low-income discount program.
- ♦ The value of the low-income discount program to recipients has decreased in the last five years.
- ♦ The low-income discount program provides a direct financial subsidy. This does not otherwise generate significant secondary public benefits compared with weatherization, energy efficiency, or other energy programs.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Amend statute to implement a proportional allocation system within the System Benefit Fund. After allocations for education, market oversight, and program administration are made, 75 percent of System Benefit Fund appropriations to the Public Utility Commission would be allocated to the low-income discount program. At least 20

percent would be allocated for energy efficiency and weatherization programs to be administered by the Texas Department of Housing and Community Affairs. Up to 5 percent of funds could be allocated for bill payment assistance to critical-care residential customers.

- ♦ **Recommendation 2:** Include a contingency rider in the 2014–15 General Appropriations Bill to reduce System Benefit Fund appropriations to the Public Utility Commission, and appropriate a like amount to the Texas Department of Housing and Community Affairs for energy efficiency and weatherization programs.
- ♦ **Recommendation 3**: Amend statute to expand the allowable use of the System Benefit Fund to finance a credit enhancement loan program. The Texas Department of Housing and Community Affairs would administer the program. This program would assist in providing low-interest loans for purposes of financing energy efficiency, weatherization, and other energy projects in the state.
- ♦ **Recommendation 4:** Include a contingency rider in the 2014–15 General Appropriations Bill to appropriate $10 million in General Revenue–Dedicated Funds from the balance of the System Benefit Fund to the Texas Department of Housing and Community Affairs as capitalization for the loan program created by Recommendation 3.
- ♦ **Recommendation 5:** Include a contingency rider in the 2014–15 General Appropriations Bill directing the Texas Department of Housing and Community Affairs to submit a report to the Texas Legislature on the loan program. The report should include details on loan performance including the level and category of individual investments, the optimal level of funding needed to meet projected demand, as well as additional recommendations on how to optimize the program for future needs. The report would be due no later than December 1, 2014.

DISCUSSION

Revenue for the System Benefit Fund (SBF) is generated by a mandatory surcharge on electric utility payments. The fee, administered by the Public Utility Commission (PUC), can be set up to $0.65 per megawatt hour consumed in deregulated areas of the state. Fund deposits may be appropriated only to provide funding for the purposes in the Texas Utilities Code, Section 39. The purpose of the fund is to reduce the burden of electric utility costs on low-income populations in the state. This is accomplished primarily through the low-income discount program (Lite-up Texas). The program provides a discount on utility rates ranging from 10 percent to 20 percent. The discount percentage is applied based on the Provider of Last Resort (POLR) utility rate. The PUC has designated POLR as a back-up electric service provider in each area of Texas open to competition. Due to costs and risks associated with serving an uncertain number of customers and corresponding electricity loads, POLR rates can be set at relatively high prices compared to the general market for electricity in the state. The discount has typically been offered from May through September.

Revenue from the System Benefit Fund fee has regularly exceeded legislative appropriations out of the account. The balance has been used for state budget certification purposes. The Comptroller of Public Accounts has estimated the available balance at the end of the 2012–13 biennium to be approximately $851 million. **Figure 1** shows SBF revenue and allocations from fiscal years 2008 to 2013 (estimated).

Current statute authorizes other uses of the fund that have rarely or never been funded. One allowable use is for energy efficiency and weatherization assistance to supplement current programs at the Texas Department of Housing and Community Affairs (TDHCA). $17.9 million from the SBF was appropriated for this use in the 2002–03 biennium. Another potential use is for one-time bill pay assistance to seriously ill or disabled customers. This service is intended to avoid disconnection of utility services but has never been funded.

THE VALUE OF LOW-INCOME DISCOUNTS

For fiscal year 2011, the total number of unique program participants who received discounts in fiscal year 2011 was 915,281. The average monthly enrollment for the low-income discount program was 571,806 participants. Low-income discount recipients are also subject to the SBF charge, contributing on average $1 per month. The estimated monthly contribution is based on average residential electricity usage. The average low-income discount applied during fiscal year 2011 was $23.33 per recipient. The total number of monthly discounts applied during fiscal year 2011 was 2,868,928. The average period the discount was applied was three months per recipient, meaning that the average recipient received three total discounts on their

FIGURE 1
SYSTEM BENEFIT FUND REVENUE AND ALLOCATIONS
FISCAL YEARS 2008 TO 2013

(IN MILLIONS)		PUBLIC UTILITY COMMISSION OF TEXAS – ALLOCATIONS				
FISCAL YEAR	ANNUAL REVENUE	MARKET OVERSIGHT	CUSTOMER EDUCATION	LOW-INCOME DISCOUNT PROGRAM	ADMINISTRATION	ANNUAL TOTAL
2008	$144.04	$1.20	$0.75	$80.00	$0.95	$82.90
2009	$137.93	$1.20	$0.75	$90.00	$0.95	$92.90
2010	$141.59	$1.20	$0.75	$119.57	$1.00	$122.53
2011	$147.57	$1.20	$0.75	$132.29	$1.00	$135.25
2012	$153.85*	$6.04	$0.75	$73.64	$0.81	$81.23
2013**	$155.88*	$6.04	$0.75	$78.54	$0.81	$86.14

*Per Comptroller of Public Accounts, Certification Revenue Estimate, 2012–13.
**Estimated.
Sources: Legislative Budget Board; Comptroller of Public Accounts.

utility bill. The average annual assistance was a net of $57.99 per recipient for fiscal year 2011.

Figure 2 shows the average monthly discount program participants may have received from fiscal years 2007 to 2012. For illustrative purposes, the estimated average cost of electricity and the effective date of the discount are also included. The value of the discount has varied throughout the lifetime of the program. Since fiscal year 2007, the amount of the discount to recipients has fluctuated, but decreased overall by approximately 6 percent. This decrease is based on funding levels, changes in the average cost of electricity and the discount rate offered by the PUC.

WEATHERIZATION AND ENERGY EFFICIENCY PROGRAMS

The SBF as well as other public benefit funds (PBFs), as they are commonly referred to in other states, were developed as part of the process of electric deregulation to fund energy efficiency programs and provide assistance to low-income customers. Low-income assistance remains a component of most PBFs. These funds have also been expanded to address energy efficiency and renewable energy projects. In contrast to many other programs across the country, Texas does not consistently allocate SBF revenue to energy efficiency or renewable energy programs.

The Electric Reliability Council of Texas (ERCOT) recently reported that future electricity supplies could potentially be constrained. For reliability purposes, ERCOT has a reserve margin target of 13.75 percent of electric generation capacity to exceed the forecasted peak demand on the grid. The *2012 Capacity, Demand and Reserves (CDR)* report shows a projected reserve margin of only 9.8 percent by 2014. This margin reduction is predominately attributed to a growing population and subsequent increases in energy demand in the state. Residential electricity usage fluctuates greatly depending on the time of year and time of day. For example, during the spring, residential usage accounts for approximately 25 percent of peak electricity demand for all sectors. During peak hours during the summer, however,

FIGURE 2
AVERAGE LOW-INCOME DISCOUNT AMOUNTS
FISCAL YEARS 2007 TO 2012

FISCAL YEAR	AVERAGE MONTHLY DISCOUNT	AVERAGE COST OF ELECTRICITY (CENTS PER KWH)	DISCOUNT RATE	EFFECTIVE DATE OF CHANGE IN DISCOUNT
2007	$24.90	12.5	12.0%	July 1, 2007
2008	$37.80	13.9	20.0%	May 1, 2008
2009	$41.99	14.8	15.5%	March 23, 2009
2010	$32.35	13.4	17.0%	August 1, 2009
2011	$23.33	12.2	10.0%	February 10, 2011
2012	$ 21.68	11.7	10.0%	February 10, 2011

Sources: Legislative Budget Board; Public Utility Commission.

increased usage of air conditioning units from residential customers, on top of what can be considered normal electric grid consumption, can account for 50 percent of the total electric demand. A potential strategy to aid in alleviating this supply shortage is to increase support of energy efficiency initiatives. Increasing deployment of energy efficiency measures could reduce strain on the electric grid, reduce utility bills for end-users, and potentially affect electricity rates and reduce air pollutants.

TDHCA is the administrator for programs related to energy efficiency and weatherization, including the federally based Weatherization Assistance Program (WAP). These programs have historically been funded by federal funds from the Department of Energy (DOE) and the Department of Health and Human Services' Low Income Home Energy Assistance Program (LIHEAP). The program goal is to reduce the energy cost burden of low-income households by making their homes more energy efficient. Weatherization services may include: weather-stripping; home energy audits; additional insulation; and modifications to appliances or home heating and cooling systems. Homeowners are eligible to receive WAP assistance. Renters are also eligible, but must have written approval from their landlord.

Low-income households eligible for WAP assistance have a disproportionate amount of their income applied for home energy costs. This amount is estimated as 12.2 percent of annual income versus 3.7 percent for non-WAP eligible households. According to TDHCA, clients served through WAP typically have older homes and older less energy efficient appliances. Typical annual federal funding for WAP received by Texas from DOE and LIHEAP is approximately $14.9 million. This funding provides weatherization assistance to approximately 3,700 households annually. According to a 2005 DOE study, the benefit to each household is estimated to be $437 in annual utility cost savings. Benefit lifetimes could be for up to 15 to 20 years, depending on the type of weatherization upgrade and the condition of the dwelling. TDHCA reports that there are approximately 14,000 Texas households on the WAP waiting list.

Regular funding for WAP in Texas is based on federal allocation. The state may supplement this federal funding to increase the number of households that are able to be serviced. The cost cap placed by the DOE on weatherized units through the WAP program is $6,769. The LIHEAP cap is $4,000. The total that can be spent on a unit without a waiver requirement is $10,769. DOE estimates an average of 30.5 MBtu (8939 kWh) of energy per household is saved annually as a result of weatherization. This savings translates to a 23 percent reduction in primary heating fuel use and a 32 percent reduction in gas space heating. Taken together, for every $1 invested in the program, comprehensive weatherization services are estimated to return $2.73 in energy and non-energy related benefits. Of this, $1.65 is attributed to direct energy-related benefits. The remaining $1.07 is attributed to other benefits; pollution reductions, unemployment improvements and an alleviation of adverse health concerns. The range of savings is contingent on the type of energy efficiency and weatherization service provided and the usage patterns of the recipient.

Texas received approximately $327 million in Federal Funds through the American Recovery and Reinvestment Act of 2009 (ARRA) to be used through WAP. This allowed TDHCA to fund the weatherization of more than 38,000 homes, surpassing weatherization goals set by the DOE by 7,000 homes. The ARRA-funded Weatherization Training Academy has contributed to the training of more than 3,000 contractors, electricians and other technicians. As ARRA funds have been expended, the state has an opportunity to continue to support this increased network of contractors and other weatherization-related personnel.

ONE-TIME BILL PAYMENT ASSISTANCE

Another currently allowable use of System Benefit Fund expenditures which has never been funded relates to one-time bill payment assistance. This program is for SBF-eligible customers who have been threatened with disconnection of utility services for nonpayment and who are or have in their household seriously ill or disabled low-income persons. The health or safety of those persons may be negatively affected by the disconnection of services. Program funds would be allocated by PUC semi-annually (September through February and March through August). Customers are limited to receiving this assistance once per fiscal year. Financial assistance is provided in the lesser of $1,000 or the outstanding balance from the last three monthly bills for electric service. PUC may adjust the limit on the amount of assistance customers may receive.

The Comprehensive Energy Assistance Program (CEAP) is a federal utility assistance program administered by TDHCA. CEAP is intended to assist low-income households in meeting their immediate energy needs and to encourage consumers to control energy costs through energy education. Entities served via CEAP include households comprised of

elderly and disabled persons. An energy crisis component provides short-term assistance in "weather-related and energy supply shortage emergencies and other energy-related emergencies that affect widespread numbers of households." As there is overlap between this component of CEAP and the SBF allocation for bill payment assistance for the elderly and disabled, TDHCA and PUC may coordinate to effectively assist eligible populations with utility services.

Recommendation 1 would amend the Texas Utilities Code, Section 39.903, to develop a proportional allocation system for future SBF expenditures. After allocations for education and program administration are made, 75 percent of SBF appropriated to PUC would be allocated to providing discounts from 10 percent to 20 percent for low-income customers. At least 20 percent would be allocated for energy efficiency and weatherization for low-income electric customers. Up to 5 percent would be allocated for bill-payment assistance to critical care residential customers. Recommendation 2 would include a contingency rider in the 2014–15 General Appropriations Bill to reduce SBF appropriations to PUC and appropriate a like amount to TDHCA. This would supplement appropriations of Federal Funds for LIHEAP and WAP, administered by TDHCA. Allocating SBF funds for other utility assistance purposes would provide eligible recipients a greater and more robust set of benefits. Allocations of SBF funds currently occur only during five months of the fiscal year (during the summer months when electricity usage and costs are highest). The benefits of weatherization or energy efficiency services could be realized year round and throughout the lifetime of the upgrade.

Allocating 20 percent of SBF appropriations for energy efficiency and weatherization services could more than double the level of funding available to TDHCA to $32.9 million annually depending on the appropriation amount. This allocation is based on prior appropriations made from fiscal years 2004 to 2008 for weatherization services at TDHCA, as well as the median annual SBF appropriation from fiscal years 2007 to 2011 of $90 million. State funds would act as supplemental funding for Federal Funds the state receives in a given year to support LIHEAP and WAP. According to data from DOE and TDHCA, it is estimated that the average cost to weatherize a home for the WAP program is $4,926. This supplemental increase to WAP would potentially provide funding to weatherize 3,654 additional homes annually. The estimated annual avoided electricity consumption per treated household is 3,352 kWh. This savings could lead to a cumulative reduction in carbon dioxide emissions in excess of 7,000 short tons annually. The amount of electricity needed to be generated during peak demand hours would also be reduced. This reduction would thereby contribute to a marginal reduction in electric grid demand and electricity pricing during these periods. However, unless SBF appropriations are increased from current levels, this reallocation of funds could reduce the level of discount low-income discount program customers received. Were Recommendations 1 and 2 in effect during the 2012–13 biennium, the program would have had to been appropriated 33 percent more in funds to fund the low-income discount program at current 2012–13 biennial levels.

ENERGY FINANCING PROGRAMS IN OTHER STATES

According to research published through the Brookings-Rockefeller Project on State and Metropolitan Innovation, a variety of public benefit funds (PBF) have been developed in at least 20 states to invest or finance clean energy projects, as shown in **Figure 3**. The main sources of revenue for many of these funds are derived from PBF program fees. Annual expenditures of PBFs vary greatly, from approximately $1 million to more than $300 million. Program mechanisms used include one or a combination of rebates, grants, loans, and performance based incentives.

CREDIT-ENHANCED LOANS

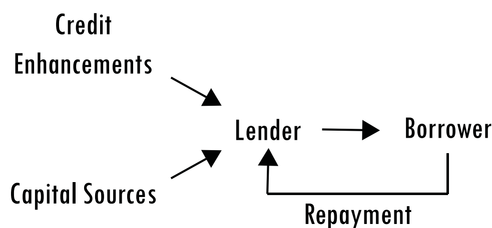
Credit-enhanced loans are loans in which a lender is assisted by a third-party entity in assuming a portion of the loan risk that would have ordinarily have been born solely by the lender. Through this mechanism, government funds can be used to encourage lenders to offer competitive loans to specific market segments. In these agreements, private banking institutions or credit unions maintain the role of funding, originating, and servicing the loan. This relationship is similar to a standard loan, but allows for better terms in the loan arrangement. These terms could include lower interest rates or more flexible underwriting standards, such as extended loan periods. Funds provided by the government are not directly involved in the actual loan, but serve as risk-mitigation tools for lenders. **Figure 4** shows how a credit enhancement interacts with a normal loan financing operation.

FIGURE 3
STATE INVESTMENT IN RENEWABLE ENERGY VIA PUBLIC BENEFIT FUNDS
FISCAL YEAR 2010

STATE	2010 FUNDING (IN MILLIONS)	PROJECTED TOTAL FUNDING (IN MILLIONS)
Alaska	$50.0	$250 from 2008 to 2013
California	$363.7	$4,566 from 1998 to 2016
Connecticut	$30.0	$445 from 2000 to 2017**
Delaware	$3.6	$49.6 from 1999 to 2017**
District of Columbia	$2.0	$8.3 from 2004 to 2012
Hawaii	$2.6	$23.5 from 2009 to 2017**
Illinois	$5.5	$97 from 1998 to 2015
Maine	$1.3	$4.2 from 2002 to 2010
Maryland	$11.8	$5.3 from 2009 to 2015**
Massachusetts	$25.0	$524 from 1998 to 2017**
Michigan	$7.0	$43.2 from 2001 to 2017**
Minnesota	$19.5	$327 from 1999 to 2017**
Montana	$1.2	$18.5 from 1999 to 2017**
New Hampshire	$1.3	$1.5 from 2010 to 2020**
New Jersey	$41.7	$534 from 2001 to 2012
New York	$15.6	$114 from 1999 to 2011
Ohio	$2.5	$50 from 2001 to 2010; $5 per year from 2011 to 2013***
Oregon	$14.2	$200 from 2001 to 2017*
Pennsylvania	$0.8	$63.3 from 1999 to 2010
Rhode Island	$2.5	$42.6 from 1997 to 2017**
Vermont	$4.3	$33.3 from 2004 to 2012
Wisconsin	$8.2	$90.4 from 2001 to 2017**

*Scheduled to expire in 2025.
**No specified expiration date.
***Estimated.
NOTE: Figures include only funds supported by utility ratepayer surcharges, with the exception of Alaska's legislatively appropriated fund. Figures do not include American Recovery and Reinvestment Act funds, funds that support Renewable Portfolio Standard (RPS) efforts or funds that are raised through bonds or legislative appropriations.
SOURCES: Brookings-Rockefeller Project on State and Metropolitan Innovation; Clean Energy States Alliance; The Database of State Incentives for Renewable Energy.

FIGURE 4
CREDIT ENHANCEMENT LOAN FINANCING PROCESS



SOURCE: U.S. Department of Energy.

Credit enhancements may be structured in a variety of ways, including:

- Loan Loss Reserve—sets aside a certain amount of money (reserves) to cover potential losses due to lack of repayment.
- Loan Guarantee—covers the entire amount of a capital provider's potential losses on a portfolio of loans. Guarantees are separate from loss reserves because they are not capped by the amount of money set aside in the reserve.
- Debt Service Reserves—funds set aside to cover potential delayed or defaulted payments on a loan.

THE INTEREST RATE REDUCTION PROGRAM

An example of a credit enhancement program in Texas is the Interest Rate Reduction Program (IRR). The IRR is operated by the Texas Department of Agriculture and Texas Agricultural Finance Authority. The IRR program is designed to reduce the loan interest rate for creditworthy entities starting or expanding their agricultural business in Texas. The program provides lenders with additional sources of funds to meet underwriting requirements. This approach has been viewed as a successful mechanism of leveraging public funds in a way that manages risk to the State.

Any financial institution that makes commercial loans and is an approved depository for state funds is eligible to participate in the program. The lender and the borrower, not the state, determines terms such as repayment, maturity and collateral loan obligations. If the loan maturity extends beyond the state's fiscal biennium then the interest rate is recalculated. The maximum loan amount in the IRR Program is $500,000. The Comptroller of Public Accounts (CPA) sets the minimum interest rate based on current U.S. Treasury bill rates. CPA may also set rates based on a note of comparable maturity minus 2 percent, with a minimum rate of 1.5 percent. The eligible borrower's loan interest rate is capped at the linked deposit rate plus 4 percent.

Various levels of government in the U.S. have already instituted forms of credit enhancement programs intended to assist in energy system financing. Examples of existing programs are shown in **Figure 5**. Financing amounts range from approximately $2.7 million to $255 million. The scopes of these programs vary; some are eligible only to homeowners, whereas others allow for a variety of stakeholder participation.

THE LOW-INCOME HOUSING TAX CREDIT PROGRAM

TDHCA administers programs that can potentially directly affect SBF populations. The Low-Income Housing Tax Credit (HTC) Program is an indirect Federal subsidy. It is used to finance the development of affordable rental housing for low-income households. Housing and community development agencies use these tax credits to increase the supply of affordable housing in their communities. TDHCA is the administrator of this program in Texas.

The HTC Program encourages private investment in the new construction or retrofitting of affordable rental housing. The program accomplishes this by providing owners tax credits that reduce their federal income tax liability. The value of the tax credits allows developers to offer reduced rents to income-qualified tenants.

Private for-profit and nonprofit developers are eligible to participate. The state receives a per capita allocation of tax credits from the federal government. In 2012, this per capita allocation was $2.20. TDHCA estimates that approximately $56 million in tax credits will be available for 2013. Awardees receive these tax credits annually for 10 years, so that the total value of this allocation is $560 million. The HTC program is estimated to assist 11,688 households in the 2012–13 biennium. According to national research and information provided by TDHCA, the HTC program has the lowest default rate among any real estate class. For example, from 1986 to 2006, the foreclosure rate for HTC-related developments has been less than 0.1 percent.

Developments assisted through the HTC program have the option of integrating additional energy efficient components into their construction. These may include Energy Star appliances and achieving national certification in energy efficiency through such standards as the National Green

FIGURE 5
EXAMPLES OF CREDIT ENHANCEMENT PROGRAMS

TITLE	LOCATION	FINANCES	CREDIT STRUCTURE	ELIGIBILITY
Rural Energy for America Program	U.S. Department of Agriculture	Allocated $255 million by Congress since 2009	Loan Guarantee and Grant Program	Rural agricultural producers and small businesses
GreenSun Hawaii	Hawaii (Hawaii Community Reinvestment Corporation)	Able to leverage $2.7 million in state funding into approximately $53.0 million in loans	Loan Loss Reserves	Residential homeowners, businesses, nonprofits and multi-family property owners
The Keystone Home Energy Loan Program	Pennsylvania (AFC First Financial Corporation)	Has provided over $42 million in financing assistance for 7,000 homeowners	Reduced rate loans	Homeowners making qualifying improvements

Source: Legislative Budget Board.

Building Standard or Leadership in Energy and Environmental Design (LEED). Credit-enhanced loans provide a quick way to leverage funds and may lead to increased interest in this area.

Recommendation 3 would amend the Texas Utilities Code, Section 39.903, to expand the allowable use of the System Benefit Fund to include a credit enhancement loan program. This program would be administered by TDHCA. The program would provide reduced interest loans, loan loss reserves or other effective financing terms, for the financing of energy efficiency and renewable energy projects. Loans to projects that directly benefit low-income populations would be prioritized. TDHCA would adopt rules related to program structure and eligibility requirements to properly prioritize loans that would benefit low-income or SBF eligible populations. The agency may coordinate this loan program to augment other existing TDHCA programs. This coordination would enhance the incentive for higher levels of energy-savings systems to be integrated into construction or renovation projects.

Credit-enhanced loans may be used for increasing the deployment of energy efficiency and renewable energy products. Loan programs can specifically target low-income populations. Credit-enhanced loans can be used for individual product installations or whole-building upgrades. Compared to the low-income discount program which targets end-users, a loan program could offer financing to local governments, private developers, nonprofits and other entities that construct or conduct major renovations in areas that house low-income populations, thus directly and positively affecting future utility costs for those populations.

Recommendation 4 would include a contingency rider in the 2014–15 General Appropriations Bill to appropriate $5 million in fiscal year 2014 and $5 million in fiscal year 2015 in General Revenue–Dedicated Funds from the unexpended SBF balance. This funding would capitalize the loan program in Recommendation 3. This program could be combined with existing federal and local subsidies, including possible rebate programs and tax incentives. This would further enhance the ability for interested parties to finance the installation of energy-enhancing services for low-income populations. As the program would be funded from the SBF, program recipients or project locations should be within the deregulated ERCOT zone.

Recommendation 5 would include a contingency rider in the 2014–15 General Appropriations Bill directing TDHCA to produce an interim report to the Texas Legislature detailing the loan program developed through Recommendation 3. The report would include an assessment on loan performance, including the level and category of individual investments, an estimated optimal level of funding to meet projected demand, as well as additional recommendations on how to optimize the program for future needs. The report would be due no later than December 1, 2014.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendations 1 and 2 would amend statute and include a contingency rider to change the allocation of the System Benefit Fund appropriations. Assuming no increase in overall SBF appropriations, SBF appropriations to the PUC would be reduced and an appropriation of a like amount would be made to TDHCA. No net fiscal impact is anticipated as a result of the recommendations. However, should the Legislature choose to maintain Lite-up Texas at its current funding level, SBF balances could be used to fund these additional programs. This would result in increased appropriations from the SBF.

Recommendations 3 and 4 implement a new loan program to be administered by TDHCA. The program would be capitalized with $10 million in General Revenue–Dedicated Funds in the 2014–15 biennium. This is approximately 1 percent of the projected balance in the System Benefit Fund account. The five-year fiscal impact of Recommendation 3 and 4 is shown in **Figure 6**.

FIGURE 6
FIVE-YEAR FISCAL IMPACT OF RECOMMENDATIONS 3 AND 4, FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE–DEDICATED FUNDS
2014	($5,000,000)
2015	($5,000,000)
2016	--
2017	--
2018	--

SOURCE: Legislative Budget Board

Recommendation 5 would direct TDHCA to produce an interim report, contingent on the implementation of Recommendation 3. It is assumed that this could be performed within existing resources and would have no fiscal impact.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

IMPROVE WEATHERIZATION ASSISTANCE PROGRAM AND EXPANDED FEDERAL PROGRAMS

The Weatherization Assistance Program helps low-income families reduce home energy costs. The U.S. Department of Energy grants federal funds to states, and the Texas Department of Housing and Community Affairs, in turn, pays local providers. Providers hire contractors to weatherize homes. Energy efficiency services range from safety checks to replacing heating and cooling units.

The American Recovery and Reinvestment Act of 2009—economic stimulus legislation—greatly increased the Weatherization Assistance Program. The Texas Department of Housing and Community Affairs' typical annual program budget is approximately $13 million. This includes Weatherization Assistance Program and Low-Income Home Energy Program funds. The American Recovery and Reinvestment Act granted $327 million to the state Weatherization Assistance Program. This increase in funding led to new challenges. This paper examines how the Texas Department of Housing and Community Affairs administered this program.

FACTS AND FINDINGS

- As of September 30, 2012, the Texas Department of Housing and Community Affairs had expended 99 percent of its Weatherization Assistance Program award.
- The agency planned to weatherize 33,908 units. As of August 20, 2012, it completed 55,661 units.

CONCERNS

- The Texas Department of Housing and Community Affairs could not procure weatherization services quickly. It did not have operational capacity or contracts in place, so it had to add providers to its network, which delayed the program.
- The agency offered training to providers and contractors, but it was not mandatory. The agency ordered them to re-do work due to deficiencies. Some providers made accounting errors.

RECOMMENDATIONS

- **Recommendation 1**: The Texas Department of Housing and Community Affairs needs to have contracts in place to scale-up programs when necessary.
- **Recommendation 2**: The agency also needs to set minimum, mandatory training requirements for providers and contractors.
- **Recommendation 3:** Include a rider in the introduced 2014–15 General Appropriations Bill that requires agencies to report their operational capacity for scaled federal programs to the Legislative Budget Board under certain program expansion conditions. Reports should explain goals, resources, and timeframes.

DISCUSSION

The Energy Conservation and Production Act of 1976 established the Weatherization Assistance Program (WAP). Lawmakers intended to reduce utility bills for low-income, elderly, and disabled Americans. The U.S. Department of Energy (DOE) awards funds to states using a formula based on a state's climate, low-income population, and home energy costs. States can also use up to 15 percent of their Low-Income Home Energy Assistance Program (LIHEAP) award to fund their WAP. States may apply to the U.S. Department of Health and Human Services, which administers LIHEAP, for a waiver to use up to 25 percent.

Before the American Recovery and Reinvestment Act (ARRA), a household had to be at or below 150 percent of the federal poverty level (FPL) to qualify for the WAP. Common services include energy audits, caulking, weather stripping, insulation, and heating or cooling unit upgrades. DOE calls this the "whole house" method or Weatherization Plus. It estimates the WAP saves participating households $437 per year, on average, in utility costs.

The Texas Department of Housing and Community Affairs (TDHCA) administers this program. Before ARRA, TDHCA received between $5 million and $6 million per year from DOE for the WAP. The agency also used about $8 million in LIHEAP funds. Its typical annual budget is approximately $13 million.

The agency awards funds to local providers, mostly Community Action Agencies and non-profits, based on geographic need. Before ARRA, TDHCA used 34 in-network

providers. Homeowners apply to providers, not TDHCA, for services. Providers hire contractors to weatherize homes. Historically, demand for service has exceeded capacity. Providers maintain a waiting list. In Texas, more than 14,000 households were on the waiting list before ARRA, according to TDHCA.

ARRA

ARRA was enacted February 17, 2009. Energy efficiency and conservation were key goals of the legislation. It granted $5 billion to the WAP. To put that figure in context, Congress appropriated nearly $8.7 billion for the program from 1977 to 2008, according to the Congressional Research Service. Put another way, the ARRA grant was greater than half of all WAP funds appropriated over 30 years. DOE planned to weatherize more than 600,000 homes in three years.

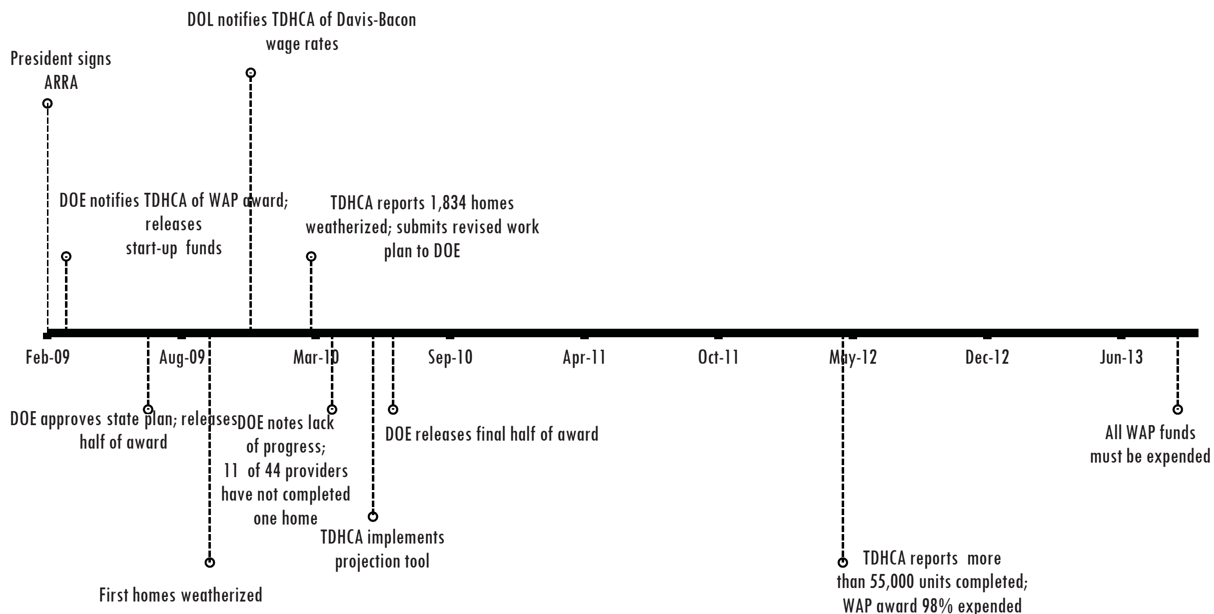
As shown in **Figure 1**, TDHCA received its award notice March 12, 2009. The $327 million grant was 25 times greater than its historical annual budget. DOE released funds in stages. The agency released a small portion for start-up costs when it awarded the grant. In July 2009, after TDHCA completed a state plan, DOE released the first half of the award. In July 2010, after TDHCA weatherized 30 percent of homes in its plan, DOE released the final half.

ARRA changed policy. It broadened eligibility from 150 to 200 percent of the FPL and raised the average per home expenditure from $2,500 to $6,500. It raised the amount of the federal appropriation DOE may permit for Training and Technical Assistance from 10 percent to 20 percent. Providers also had to follow Buy American and Davis-Bacon laws. The WAP had been exempted from these laws before. Buy American meant all iron, steel, and manufactured goods had to be made in the U. S. Davis-Bacon, meanwhile, required providers to pay contractors prevailing wage rates. The U.S. Department of Labor (DOL) determined rates for each county. As this report will further explain, Davis-Bacon requirements delayed many WAP operators, including TDHCA.

TDHCA INITIAL RESPONSE

The agency planned to weatherize nearly 34,000 units. The program, however, got off to a slow start. The agency did not

FIGURE 1
MAJOR MILESTONES
FEBRUARY 2009 – SEPTEMBER 2013



NOTES: ARRA=American Recovery and Reinvestment Act; DOE=Department of Energy; TDHCA=Texas Department of Housing and Community Affairs; WAP=Weatherization Assistance Program; DOL=Department of Labor.
SOURCES: Legislative Budget Board; Government Accountability Office; Texas Department of Housing and Community Affairs; Comptroller of Public Accounts; Office of Management and Budget.

weatherize a single home until seven months after it received its award notice. According to TDHCA officials, Tri-County Community Action Association, a provider, completed the first homes in October 2009. TDHCA weatherized fewer than 50 homes by year's end, the U.S. Government Accountability Office (GAO) reported. By March 31, 2010, TDHCA reported just 1,834 homes completed, fewer than 20 percent the number it needed to complete to receive second-half funds.

There were many reasons for the slow start. From the outset, TDHCA officials knew procurement would be an issue. For one, the agency needed more providers to handle more work. Also, many contractors were "mom and pop" shops that serviced smaller scale, single family units. ARRA offered opportunities to service larger multifamily units. Furthermore, TDHCA would not authorize work until after DOL set wage rates. DOL notified the agency of final wage rates in December 2009.

The provider network evolved over time, but there were challenges. TDHCA initially planned to add more than 40 new providers. The new group would include small, medium, and large cities and non-profits. According to TDHCA officials, DOE advised against using the small cities and non-profits, which left 33 pre-ARRA providers and 20 medium-to-large cities. Eight of these cities, however, later chose not to participate. Fourteen providers returned $29 million in program funds, *The Texas Tribune* reported, because "they weren't prepared to administer the program." TDHCA noted these funds were re-directed to other providers, and all 14 providers continued to operate a program.

All providers dealt with new rules. Many providers and contractors had little experience with these accounting, auditing, and reporting demands. TDHCA officials, for instance, said providers had concerns moving from the EZ Audit to the National Energy Audit Tool, a more technical system. To help providers and contractors adapt to new rules, the agency formed a Training Academy. It provided technique, project management, production, and other guidance. TDHCA, however, did not set minimum, mandatory training standards. DOE did not require mandatory training.

Nevertheless, mandatory worker training may have reduced errors and improved efficiency. Some agencies, GAO noted, "rushed to meet their monthly production targets, and the weatherization work suffered, requiring local agencies to conduct rework." As workers received more training, however, they did not have to fix past work. GAO cited Washington as a state that had less trouble balancing training and production. It hired trained employees. After it reviewed more than 130 TDHCA monitoring reports, *The Texas Tribune* reported, "providers consistently had problems accurately documenting expenses and conducting energy audits, which in some cases led to thousands of dollars in unexplained costs and improper installations of energy efficient materials. More than half of the 3,500 weatherized homes inspected by the TDHCA had workmanship deficiencies contractors were ordered to return to fix." Mandatory training might have prevented some of these issues.

OFFICIALS EXPRESS CONCERN

Oversight authorities were concerned about TDHCA's handling of the WAP. In hearings, members of the House Committee on Federal Economic Stabilization Funding asked agency officials why funds were spent slowly. In May 2010, GAO reported the agency had made "progress" but needed to "overcome several vulnerabilities." DOE "had not been pleased" with Texas' progress, GAO noted.

GAO's report elaborated on early delays. It mentioned that TDHCA waited for DOL to set wage rates, as other states did, to avoid paying back wages. It also described the agency's attempt to establish a provider network. DOE had advised the agency to emphasize its existing provider network. It expressed concern that new cities were not meeting production goals. TDHCA officials also told GAO their concern that some providers might not meet targets. By April 7, 2010, 11 of 44 providers had not completed any homes.

GAO noted TDHCA had some monitoring procedures in place, but it could improve them. A site visit found one Houston provider had "workmanship deficiencies" in 33 of 53 units. Another visit to the City of Houston found problems with client files. GAO recommended TDHCA pay more attention to new providers.

DOE also conducted monitoring visits and audits. In its Interim Report, the House Committee on Federal Economic Stabilization Funding noted DOE's concerns, shown in **Figure 2**.

OTHER STATES EXPERIENCED SIMILAR CHALLENGES

Many states had challenges managing the WAP. According to a DOE report, one year after ARRA passed grantees had drawn down less than eight percent of funds. Just two of ten

FIGURE 2
U.S. DEPARTMENT OF ENERGY CONCERNS AND TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS RESPONSE

SELECTED CONCERN	AGENCY RESPONSE
Vacant positions	Filled positions
Improve communication between program officers and fiscal staff	Ensured fiscal personnel could withhold payment when officers found poor performance
Deobligate funds from a failing agency, find replacement	Deobligated funds. Contracted replacement
Schedule more energy audit training	Increased training. Trained 216 persons in auditing
Outsource multifamily energy audits	Provided list of engineering firms to sub-recipients
Better explain $6,500 average per unit cost	Communicated to sub-recipients this was an average, not maximum, cost. Projects may exceed $6,500
Make sure client files are complete	Provided further guidance and technical assistance to sub-recipients about documentation requirements

Source: House Committee on Federal Economic Stabilization Funding, Interim Report, December 2010.

FIGURE 3
WEATHERIZATION ASSISTANCE PROGRAM RECIPIENTS THAT REPORTED THESE CHALLENGES DURING FIRST PROGRAM YEAR, APRIL 1, 2009 TO MARCH 31, 2010

SELECTED CHALLENGES	PERCENTAGE
Balancing the requirements to meet production targets and to ensure work is done correctly	91%
Meeting production targets	91%
Having additional reporting requirements	90%
Implementing new program requirements that were developed as the program progressed	89%
Implementing Davis-Bacon requirements	88%
Balancing training and technical assistance requirements with production targets	88%
Adjusting to changes in existing reporting requirements	87%
Meeting federal reporting requirements	84%
Meeting certification and training requirements	83%
Lacking expertise weatherizing multifamily units	82%
Having too few monitoring staff	81%
Having insufficient administrative staff	76%
Having additional reporting requirements for monitoring	75%

Sources: Legislative Budget Board; Government Accountability Office.

states with the largest awards had weatherized more than two percent of their target units.

The DOE Inspector General called the lack of progress "alarming." DOE placed some of the blame upon itself. "Despite its best efforts, the Department's action to reduce or eliminate program delays appeared not to have significantly increased the tempo of actual units weatherized across the Nation," the report said. It noted the program required all participants, from federal officials to subcontractors, to deal with an "overwhelming increase in funding."

A GAO survey of WAP operators revealed nearly all faced similar issues, especially during the first year. As **Figure 3** shows, about nine in ten faced challenges balancing the need to meet production targets with ensuring work was done properly (91 percent); meeting production targets (91 percent); having additional reporting requirements (90 percent); and implementing Davis-Bacon wage requirements (88 percent).

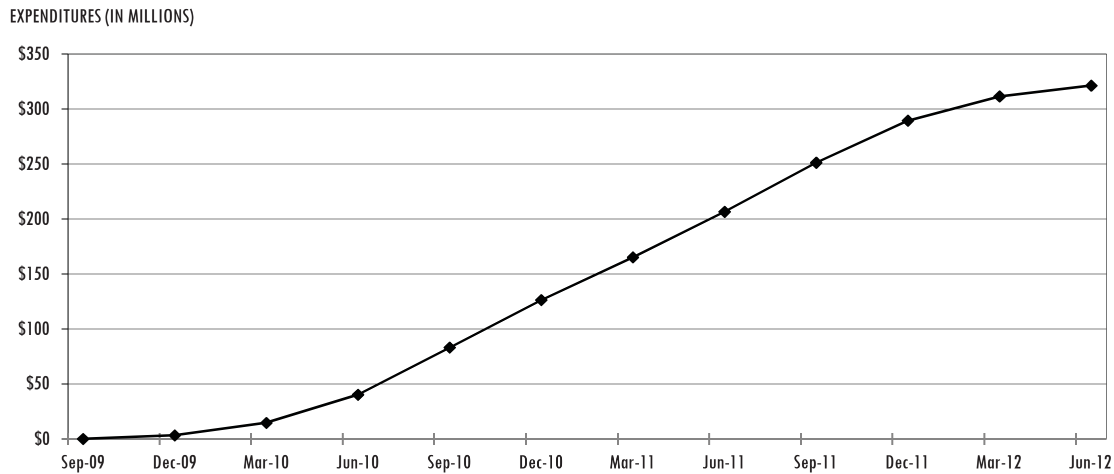
Fewer grantees experienced these issues by the third program year. Still, some problems persisted. About two in three reported that balancing the need to meet production targets with ensuring work was done correctly (68 percent) or lacking expertise weatherizing multifamily units (64 percent) were challenges. More than half still had trouble meeting production targets (57 percent).

Some states had serious issues. Delaware suspended its WAP for months due to "waste and possible corruption," *The News Journal* reported. A DOE audit found provider problems in Illinois "put the integrity of the entire Program at risk." Some consumers were also unhappy. Of the 400 complaints to a DOE hotline, half were WAP-related. Consumers complained about not getting services as promised, timeliness, and substandard workmanship.

TURNING POINT

As **Figure 4** shows, TDHCA had spent just $40.3 million, or 12 percent, of its WAP award by June 30, 2010. In June 2010, an employee developed a projection tool, agency officials told LBB staff. This allowed TDHCA to project provider completion rates. Based on past performance, the agency could predict when a provider would meet its target. For example, a high-performer might complete its homes in

FIGURE 4
CUMULATIVE WEATHERIZATION EXPENDITURES BY QUARTER
SEPTEMBER 2009 TO JUNE 2012



SOURCE: Comptroller of Public Accounts.

one year. A low-performer might not complete its homes for several years. According to agency officials, this data allowed TDHCA to reallocate funds. It took funds away from low-performers and gave them to high-performers. In addition, the agency employed a risk assessor. This employee used strategies to identify problematic sub-recipients. With these tools, TDHCA could allocate resources efficiency and meet deadlines.

The reallocation strategy appears to have greatly increased expenditures. From July 1, 2010 to September 30, 2010, TDHCA expended $42.8 million. That was a 67 percent increase above the prior quarter. Moreover, it spent more that quarter than in all previous quarters combined. From October 1, 2010 to December 31, 2010 the agency expended another $43.3 million—for $126.3 million in total. Although the agency struggled to expend funds from 2009 through the first quarter of 2010, by the end of that year it had spent more than one-third of its award.

LESSONS LEARNED AND RECOMMENDATIONS

In a Special Report, DOE's Inspector General described ARRA as a "teachable moment." "Resources were strained, the existing infrastructure was stretched, institutional barriers had to be overcome, and new programs were established on an expedited basis," the report said. In many ways, this was true of Texas' WAP. Should Texas receive stimulus or significant, one-time federal allocations again, there are several ways agencies may want to prepare.

First, agencies might evaluate how scalable existing federal programs are. That is, in the event a program's scope increases greatly, could it handle greater capacity? TDHCA, in the beginning, did not have a network that could meet ARRA's demands. It added providers, but this took time. If the agency has to lead an expanded program again, it would need contracts in place, officials told LBB staff. Recommendation 1 advises TDHCA to have contracts in place that could be executed when necessary. Second, while the agency fulfilled ARRA's minimum training requirements, it did not offer mandatory training. Because providers had to re-do work later, compulsory training could reduce paperwork and workmanship errors. Recommendation 2 advises TDHCA to provide mandatory training to WAP providers and contractors.

Finally, Recommendation 3 would include a rider in Article IX of the 2014–15 introduced General Appropriations Bill and requires agencies to report their operational capacity for expanded federal programs to the LBB. The report would explain goals, resources, timeframes and other issues critical to program execution. For example, agencies may need staff with quantitative skills. As discussed, TDHCA moved money from poor performers to better ones once it had actionable data. The report would be submitted within 90 days of a notice of grant award when either of these conditions is met: an existing federal program that historically awards an agency $10 million or more per year increases its grant by at least ten-fold, or 1000 percent; or a new federal program grants at least $100 million to a state agency. Medicaid,

however, would be exempt from reporting. It is intended these reports would help agencies evaluate goals and expectations in another ARRA-like situation.

FISCAL IMPACT OF RECOMMENDATIONS

It is anticipated that TDHCA can implement Recommendations 1 and 2 within existing agency and federal resources. Because ARRA increased the percentage of the national appropriation DOE can allow for training from 10 percent to 20 percent, it is anticipated TDHCA will have greater access to training funds. While DOE may retain three percent for national training initiatives, it may direct the remaining 17 percent to states. As a grantee, TDHCA has broad discretion how to use training funds, and DOE notes this "allows for tailored training programs that best suit individual needs." It is anticipated affected agencies can implement Recommendation 3 within agency resources.

The introduced 2014–15 General Appropriations Bill includes a rider to implement Recommendation 3.

OVERVIEW OF FEDERAL HOMELAND SECURITY FUNDS IN TEXAS

The federal Homeland Security Act of 2002 has appropriated $37.0 billion to federal grant programs since fiscal year 2002. The largest federal grant program providing funds to states is the Homeland Security Grant Program. Recently, the federal Consolidated Appropriations Act of 2012 modified distribution formulas and consolidated programs in the federal Homeland Security Grant Program. The legislation also reduced the amount of time states have to expend Homeland Security Grant Program funds from four years to two years. These and other federal provisions have made it necessary for state agencies to improve disbursement and monitoring of the Homeland Security Grant Program. Federal and state audits of the administration of homeland security grants reveal a need for better monitoring of federal funding.

Texas has been receiving federal homeland security funding since fiscal year 2002. The amount of recent federal appropriations indicate that less federal homeland security funding will be available to Texas and other states in the future. As recent state and federal audits indicate, it would be prudent for state and federal agencies to more effectively monitor the disbursement and use of homeland security funds. The Texas Department of Public Safety has implemented a management improvement plan for the recording, disbursement, and monitoring of federal homeland security funds.

FACTS AND FINDINGS

- ♦ From fiscal years 2008 to 2012, Texas state agencies and public institutions of higher education were awarded an estimated $1.1 billion from major federal homeland security programs.
- ♦ The Texas Department of Public Safety has implemented administrative changes to comply with federal homeland security grant accounting procedures as a result of a Texas State Auditor's Office report published in February 2012. The agency has implemented procedures to monitor grant sub-recipients for timely reimbursement of funding advances and to communicate all required award information in sub-recipient agreements.
- ♦ In a February 2012 report, the U.S. Government Accountability Office recommended that the U.S. Department of Homeland Security and the Federal Emergency Management Agency improve their coordination, administration and monitoring of federal homeland security and disaster grant programs.
- ♦ The U.S. Department of Homeland Security Office's Inspector General, in a June 2012 report, recommended that Federal Emergency Management Agency improve their oversight of state management of Homeland Security Grant Program and Urban Area Security Initiative grants.

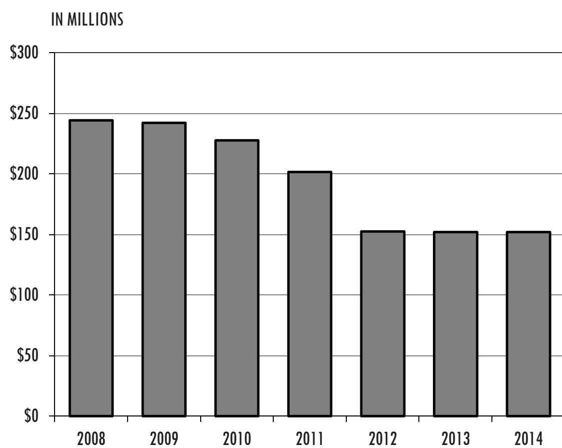
DISCUSSION

The federal Homeland Security Act of 2002 established the nation's newest executive department, the U.S. Department of Homeland Security (DHS). The legislation consolidated several federal agencies under DHS, such as the Office of Domestic Preparedness, the Federal Emergency Management Agency (FEMA), and the U.S. Coast Guard. Federal funds that were appropriated to these individual agencies are now distributed by DHS. DHS, the U.S. Department of Defense (DOD), and the U.S. Department of Health and Human Services (DHHS) provide the majority of terrorism-related homeland security funding to Texas.

From fiscal years 2008 to 2012, Texas state agencies and public institutions of higher education were awarded an estimated $1.1 billion from major federal homeland security programs. The largest of the terrorism-related homeland security grant categories distributed to states by DHS is called the Homeland Security Grant Program (HSGP). The HSGP is a cluster of several core homeland security programs that states have received since fiscal year 2002, they include: the State Homeland Security Grant Program (SHSGP); the Urban Areas Security Initiative (UASI); and Operation Stonegarden (OPSG). Other programs included in this group in previous years were the Metropolitan Medical Reserve System (MMRS); the Law Enforcement Terrorism Prevention Program (LETPP) and the Citizen Corps Grant Program (CCP). In fiscal year 2012, Texas received approximately $71.0 million from the HSGP. The Texas Department of Public Safety (DPS) administers the HSGP.

Two divisions within the DHHS oversee a select number of homeland security grant programs. The Health Resources and Services Administration (HRSA) administers the Hospital Preparedness Program (HPP) and the Centers for Disease Control (CDC) administers the Public Health Emergency Preparedness (PHEP) program. The Department of State Health Services (DSHS) administers both grants for Texas. In fiscal year 2012, Texas received $26.4 million for the HPP and $37.5 million for the PHEP. **Figure 1** shows the funding award amounts of select major homeland security grants from fiscal years 2008 to 2014.

FIGURE 1
FEDERAL HOMELAND SECURITY AWARDS TO TEXAS
FEDERAL FISCAL YEARS 2008 TO 2014



NOTES: Awards include amounts from the following the following programs: Emergency Management Performance Grants, Public Health Emergency Preparedness Grants, Hospital Preparedness Program Grants, and the Homeland Security Grant Program (cluster), which in fiscal year 2012 consists of the State Homeland Security Grants, Urban Area Security Initiative Grants and Operation Stonegarden Grants. In fiscal years 2008 to 2011, the Homeland Security Grant Program also included the Citizen Corps Program Grants and Metropolitan Medical Response System Grants. Fiscal years 2013 and 2014 are estimated.
SOURCE: Legislative Budget Board.

Other major federal homeland security grants in Texas include those received by the University of Texas Medical Branch at Galveston (UTMB) and Texas A&M University. In 2003, UTMB was awarded $120.0 million federal grants to build a national biocontainment laboratory. The laboratory is used for the study of dangerous bacteria and viruses that could cause health emergencies or pose biological threats. In June 2012, Texas A&M University received an award of $176.0 million in federal grants towards the development of a national biosecurity center. The purpose of the Texas A&M Center for Innovation is to perform research and advanced development to accelerate vaccines and to produce these products in cases of pandemics or other national emergencies.

This report primarily addresses the terrorism related funding awarded to DPS and the DSHS. A significant amount of these federal funds have been used for the following purposes:

- pass-through funds to local entities for first responder training and equipment;
- pass-through funds for specific metropolitan regions for emergency preparedness and response, training, equipment, and planning;
- border security enforcement enhancement equipment and training;
- public health bioterrorism and diseases preparedness for planning, tracking, and responding to major health threats; and
- hospital bioterrorism and emergency preparedness to equip hospitals and other public and private entities with planning, training, and equipment for response to a terrorist or other catastrophic event.

TEXAS HOMELAND SECURITY STRATEGIC PLAN

The Seventy-eighth Legislature, Regular Session, 2005, established the Governor's Office of Homeland Security. This office coordinates the Homeland Security Council and prepares the Texas Homeland Security Strategic Plan, as required by federal law. The Texas Homeland Security Strategic Plan for fiscal years 2010 to 2015 guides the state's homeland security goals, strategic objectives and strategic priorities. The Texas Homeland Security Strategic Plan establishes the following three goals:

- prevent terrorist attacks in Texas;
- protect the state by reducing exposure to natural or man-made disasters and criminal or terrorist activity; and
- respond decisively and recover quickly from terrorist and criminal actions or natural or man-made disasters.

The Texas homeland security goals align with the National Preparedness Guidelines established by the DHS in fiscal year 2007. Federal guidelines require that state homeland security plans effectively guide the implementation of homeland security related policies and procedures. Each state plan must include provisions for funding, training, infrastructure, communications, planning, and equipment.

Each state plan must also include provisions for inter-government coordination and public private partnerships that help in achieving state and federal goals. The Texas plan was developed to meet the unique homeland security needs of the state. Those needs include accounting for Texas geographical size, location, land and sea borders and demographics. Since fiscal year 2004, federal funding has been the largest source of support for state and local homeland security programs.

The 2005 legislation also designated DPS's Texas Department of Emergency Management (TDEM) the single state administrator of DHS related federal homeland security funding in Texas. TDEM coordinates implementation of the state's Homeland Security Strategic Plan with the Governor's Office of Homeland Security. Oversight of Homeland Security programs and grants resides primarily at TDEM. TDEM makes recommendations regarding the distribution of federal homeland security funds. TDEM then administers applications for local and state entities applying for federal homeland security-related grant funds. The agency is also responsible for monitoring and tracking the use of homeland security funds.

HOMELAND SECURITY GRANT PROGRAM

The federal HSGP is a cluster of programs supporting the National Preparedness Guidelines. Each state qualifies for the HSGP by submitting and receiving approval of their state's homeland security plan from the DHS. The Consolidated Appropriations Act of 2012 enacted formula and distribution changes for the Homeland Security Grants Program for fiscal year 2012. New risk criteria are used to determine funding for the majority of SHSGP, UASI, and OPSG funding. Risk is evaluated at the federal level by using an analytical model developed by the U.S. Department of Homeland Security (DHS). DHS defines risk as the product of the three following principal variables:

- Threat—the likelihood of an attack occurring;
- Vulnerability—the relative exposure to an attack; and
- Consequence—the expected impact of an attack.

In fiscal year 2012, the threat analysis includes domestic and international threats. **Figure 2** provides information on the three programs that make up the federal HSGP cluster of programs.

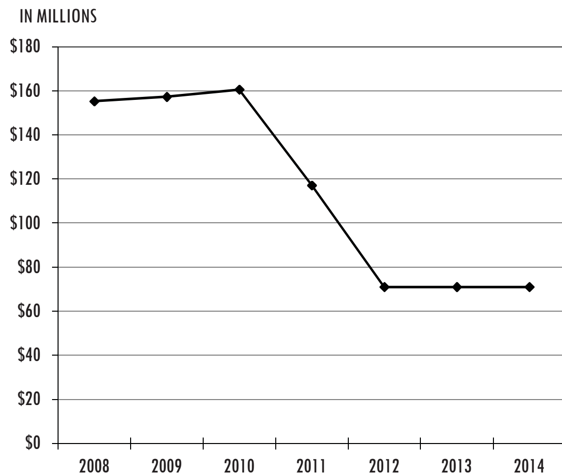
FIGURE 2
HOMELAND SECURITY PROGRAM CLUSTER
FISCAL YEAR 2012

	PURPOSE	ALLOCATION	NOTES
State Homeland Security Grant Program (SHSGP)	Provides funds to enhance the capability of state and local jurisdictions to prepare for and respond to terrorist acts.	Allocated 0.35 percent of the total federal Homeland Security State Grant program national appropriation and additional funds based on risk methodology and anticipated effectiveness based on the strength of the Investment Justification.	States are required to ensure that at least 25 percent of combined total State Homeland Security Grant Program and Urban Area Security Initiatives funds are dedicated to law enforcement terrorism prevention activities.
Urban Area Security Initiatives (UASI)	Provides financial assistance to select state metropolitan areas, to address the unique equipment, training and planning needs of large urban areas and to assist them in building an enhanced and sustainable capacity to prevent, respond and recover from threats or acts of terrorism.	Allocated based on risk analysis and the anticipated effectiveness of the proposed investments by the applicants.	Eligible cities in Texas for fiscal year 2012 include Dallas/Fort Worth/Arlington, Houston and San Antonio.
Operation Stonegarden (OPSG)	Provides financial support for enhanced cooperation and coordination among state, federal and local law enforcement agencies to secure the nation's borders along international border crossings and travel corridors in states bordering Mexico, Canada, as well as states and territories with international water borders.	Allocated competitively according to federally determined risk factors, risk assessments provided by states and anticipated feasibility and based on the strength of the Investment Justification.	Available to states bordering Canada and Mexico or states with international water borders.

Source: Legislative Budget Board.

The federal funding share is 100 percent for all programs in the HSGP cluster. Availability of funds for the HSGP cluster has been reduced from 36 to 24 months. DPS must obligate at least 80 percent of the funds awarded for SHSGP and UASI to local units of government within 45 days of receipt of the funds. In the past, DPS reports that it has not always been able to meet the 45-day distribution requirement, but has received federal approval to extend the distribution deadline. DPS also regularly passes through more than the required 80 percent of federal funds for SHSGP. **Figure 3** shows the trend of federal funds to Texas for the HSGP cluster of programs from fiscal years 2008 to 2014. The significant decrease in fiscal year 2012 is a result of federal reductions to the HSGP cluster of programs.

FIGURE 3
FEDERAL HOMELAND SECURITY GRANT PROGRAM CLUSTER AWARDS TO TEXAS
FEDERAL FISCAL YEARS 2008 TO 2014



NOTES: Awards include amounts from these programs: Homeland Security Grant Program (cluster), which in fiscal year 2012 consists of the State Homeland Security Grants, Urban Area Security Initiative Grants and Operation Stonegarden Grants. In fiscal years 2008 to 2011, the Homeland Security Grant Program also included the Citizen Corps Program Grants and Metropolitan Medical Response System Grants. Fiscal years 2013 and 2014 are estimated.
SOURCE: Legislative Budget Board.

Although no longer funded as distinct grant programs, all activities and costs allowed for the fiscal year 2011 CCP and MMRS grant programs are allowable uses for fiscal year 2012 HSGP funding. Texas HSGP funding was approved by DHS for expenditures on projects contained within five investment categories in fiscal year 2012. Allowable uses for HSGP in fiscal year 2012 are shown in **Figure 4**.

FIGURE 4
TEXAS HOMELAND SECURITY GRANT PROGRAM CLUSTER ALLOWABLE PROJECTS LISTED BY INVESTMENT CATEGORY
FISCAL YEAR 2012

INVESTMENT	PROJECT ENHANCEMENTS
Intelligence and Information Sharing: State and Regional Fusion Centers	• State Fusion Center • Recognized fusion center – Austin • Recognized fusion center – El Paso • Fusion center intelligence nodes
Interoperable Communications	• Existing communications capabilities-Upgrade • Communication capabilities
Special Response Teams and First Responders	• Special response teams • First responders • Web-based emergency operation center software
State, Regional and Local Planning	• Regional and multi-jurisdictional whole community planning • Citizen Corps Program • Regional emergency notification systems • Special response team and equipment categorization (typing), tracking and mobilizing
Border Security	• Information systems • Border operations • Personal protective equipment

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

DEPARTMENT OF STATE HEALTH SERVICES

DSHS has been receiving two homeland security grants from the DHHS since fiscal year 2002. The PHEP and HPP fund basic planning, training and equipment. The two grants are modified each year based on state and national priorities.

PUBLIC HEALTH EMERGENCY PREPAREDNESS GRANTS PROGRAM (PHEP)

PHEP funds are intended to upgrade state and local public health jurisdiction's preparedness and response to bioterrorism, outbreaks of infectious diseases, and other public health threats and emergencies. Grant funds are available for statewide coordination and planning for bioterrorism; surveillance and epidemiology capacity to local health departments; laboratory capacity and diagnostic capability to major public health laboratories across the state; critical communication networks; and education and

training for bioterrorism preparedness. Each state receives a base amount of $3.9 million, plus an amount equal to its proportional share of the national population as reflected in the U.S. Census estimates According to DSHS, the PHEP grants program has strengthened the state's ability to conduct public health surveillance and epidemiological studies through Epidemiology Response Teams. Funding has allowed Texas to hire and train staff and purchase needed communication systems, computers, and other equipment. **Figure 5** shows the PHEP funds received by DSHS from fiscal years 2007 to 2012. While Congress reduced the national PHEP funding level in fiscal year 2011, Texas' grant award has remained level at $37.5 million in fiscal year 2012.

FIGURE 5
PUBLIC HEALTH EMERGENCY PREPAREDNESS GRANTS FOR TEXAS, FISCAL YEARS 2007 TO 2012 (IN MILLIONS)

FISCAL YEAR	GRANT AMOUNT
2007	$56.2
2008	$43.4
2009	$42.9
2010	$43.2
2011	$37.5
2012	$37.5

Source: Legislative Budget Board.

DSHS has also used this funding source to purchase epidemiological tracking systems enhancing the state's technology for tracking health emergencies and providing timely alerts. Funds are also used to stockpile pharmaceuticals (including pandemic flu vaccine); provide planning, training, and emergency exercises; and to enhance coordination with several state and national programs. Examples of these state and national programs are:

- Biological Emergency Response Team;
- Center for Public Health Preparedness and Response;
- Disaster District Committee;
- Emergency Alert System;
- Epidemiology Response Team;
- Technical Advisory Response Unit; and
- Texas Voluntary Organizations Active in Disaster.

HOSPITAL PREPAREDNESS PROGRAM (HPP)

The HPP was established to prepare hospitals and supporting healthcare systems to deliver care to patients of public health emergencies. The DHHS's Office of Assistant Secretary for Preparedness allocates funding to states in the form of cooperative agreements. A state receives a base allocation plus an amount equal to the state's proportional share of the national population. **Figure 6** shows the Hospital Preparedness Program funds received by DSHS from fiscal years 2007 to 2012. While Congress reduced the national HPP funding level in fiscal year 2011, Texas' grant award increased slightly to $26.4 million in fiscal year 2012.

FIGURE 6
HOSPITAL PREPAREDNESS PROGRAM GRANTS FOR TEXAS, FISCAL YEARS 2007 TO 2012 (IN MILLIONS)

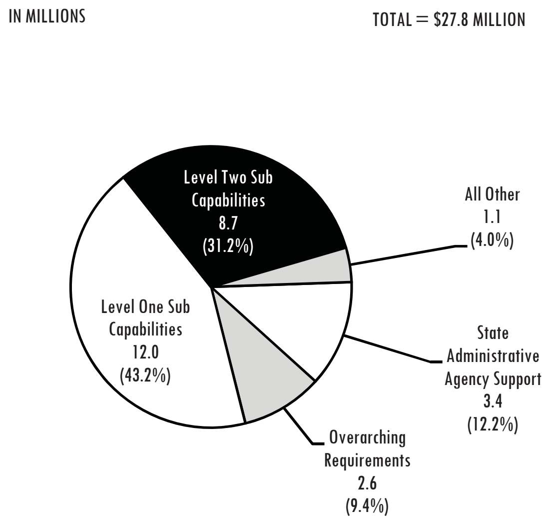
FISCAL YEAR	GRANT AMOUNT
2007	$30.3
2008	$29.0
2009	$26.2
2010	$28.4
2011	$25.4
2012	$26.4

Source: Legislative Budget Board.

DSHS is the designated State Administrative Agency for these federal funds. A significant amount of HPP funds is allocated to local hospitals, hospital districts and other qualified public and private healthcare-related entities. Up to 50 percent of the funds may be used for planning and development. The remaining funds must be used to improve hospital capacity for bioterrorism-related events and other health hazards. In Texas, expenditures are divided into four major categories: State Agency Support; Level One Sub-Capabilities; Level Two Sub-Capabilities; and Overarching Requirements. State Agency Support funds travel, supplies and personnel costs. The Level One Sub-Capabilities category includes local emergency medical stations, interoperable radio equipment and disaster planning and training for local entities. The Level Two Sub-Capabilities categories include the purchase of equipment for mobile and alternate care sites. Overarching Requirements includes the use of funds to develop and maintain the National Incident Management System integration (NIMS). NIMS monitors and provides key communication for the management of national

disasters. **Figure 7** shows HPP expenditures by category for fiscal year 2010.

FIGURE 7
TEXAS HOSPITAL PREPAREDNESS PROGRAM USE OF FUNDS BY CATEGORY
FISCAL YEAR 2010



Sources: Legislative Budget Board; Texas Department of State Health Services.

FEDERAL HOMELAND SECURITY GRANT TRACKING AND FUTURE FUNDING

The Homeland Security Act of 2002 appropriated $37.0 billion to federal grant programs for states from federal fiscal years 2002 2011. Beginning with the federal Consolidated Appropriations Act of 2008, federal appropriations have included provisions to consolidate programs or change distribution formulas for homeland security grants. The federal Consolidated Appropriations Act of 2012 reduced appropriations for the national Homeland Security Program state and local grant program from $3.4 billion in fiscal year 2011 to $2.4 billion in fiscal year 2012, a $1.0 billion or 29.4 percent reduction. The federal Budget Control Act of 2011 (BCA) may further reduce homeland security funding for states in fiscal year 2013. The BCA would reduce funding for five of the terrorism-related homeland security grants in Texas by 8.2 percent, from $109.8 million to $100.8 million. Each time Congress changes or consolidates homeland security program provisions, the methods for tracking and reporting the funds is also modified. Federal and state audits have verified that constant changes made to federal homeland security grants from fiscal years 2005 to 2012 have caused difficulties for state and federal agencies in properly monitoring federal funds.

Since fiscal year 2007, DHS has been in the process of organizing a centralized grants office for most homeland security grants. The new office has been placed within the Federal Emergency Management Agency's (FEMA) Grant Programs Directorate (GPD). In a report published in February 2012, the GAO recommended that the DHS and the FEMA put measures in place to improve their coordination, administration, and monitoring of federal homeland security and disaster grant programs. In June 2012, the Office of Inspector General of DHS recommended that FEMA specifically improve their oversight of state management of HSGP and UASI grants for states. DHS and FEMA responded to the GAO and OIG reports by continuing their grants management plan for the GPD. On July 25, 2012, FEMA reported to the Senate Committee on Homeland Security that they had completed the implementation of standard operating procedures for the HSGP cluster as well as other homeland security and preparedness grant programs. DHS expects that consolidated grant funding and centralized grant administration will improve the accounting of federal homeland security funds.

HOMELAND SECURITY GRANT TRACKING IN TEXAS

Recent state audits have verified that modifications made to HSGP from fiscal years 2005 to 2012 have caused grant tracking and reporting challenges for state and federal agencies. For example, a State Auditor's Office report released in February 2012 identified control weaknesses and non-compliance in DPS's administration of the Homeland Security Cluster of federal programs. SAO's report includes a finding that DPS provided hardship advances to federal grant sub recipients without obtaining proof of the sub recipient's subsequent disbursement of those funds. The SAO also noted that DPS did not conduct proper monitoring of sub recipients including site visits and review of Single Audits to ensure compliance and reduce risk. DPS agreed with the SAO's recommendations and implemented the following administrative procedures:

- In April 2012, DPS implemented procedures to follow up with grant sub recipients and require timely reimbursement of advances including the return of any earned interest required to be returned to the federal government.
- In June 2012, DPS implemented procedures to communicate all required award information in its

sub recipient agreements; include sub recipients in its risk assessment for site visits; review sub recipients' Single Audit reports within six months of receipt of those reports; and ensure that sub recipient Single Audit information in its tracking spreadsheet is accurate and complete.

- In April 2012, DPS implemented a system to accurately calculate interest earned on advanced federal funds that must be returned to the federal government.

USE PUBLIC-PRIVATE PARTNERSHIPS TO INCREASE THE NUMBER OF GROCERY STORES IN LOW-INCOME AREAS

Access to foods with high nutritional value is necessary for a healthy community. However, the geographic distribution of grocery stores in communities is uneven. Low-income areas without close access to grocery stores are called "food deserts." Individuals residing in food deserts tend to have higher rates of diet-related diseases. Several states have had success in encouraging small grocery stores to be opened in food deserts through the establishment of public-private partnerships. These partnerships use grants from the states to community development financial institutions, which leverage additional private investment to establish revolving loan funds for small to mid-size businesses that do not qualify for standard loans. By amending statute and authorizing a fund to support investment in low-income areas in need of grocery stores, Texas could increase the availability of healthy foods to underserved communities.

FACTS AND FINDINGS

- The U.S. Department of Agriculture estimates that 15 percent of Texans reside in a food desert.
- Low-income populations in food deserts have disproportionately higher rates of heart attacks, coronary heart disease, stroke, obesity, and diabetes. The Centers for Disease Control and Prevention reports with better nutrition, the effects of each of these diseases can be reversed or slowed.
- The national ratio of grocery stores to population is one store to 8,620 people. Texas averages one store per 12,000 people. It is estimated that Texas needs an additional 589 grocery stores to meet the national ratio.
- In 2004, the Pennsylvania Fresh Food Financing Initiative was established to open grocery stores in underserved neighborhoods. To date, the partnership has created approximately 5,000 jobs.
- An evaluation of research by the University of Texas Medical Branch at Galveston determined that a grocery store in a neighborhood is associated with higher fruit and vegetable consumption and lower rates of overweight and obese individuals.
- The Health and Human Services Commission estimates that 40.3 percent of Texans earning less than $20,000 a year are obese compared to 29.6 percent of Texans earning $50,000 or more a year.
- The Centers for Disease Control and Prevention estimates Texas' obesity rate for 2010 was 31 percent.

CONCERN

- Certain geographic areas where there is an absence of grocery stores are called "food deserts" and are characterized by a lack of access to healthy foods. This lack of access is linked to poorer health for residents and avoidable costs to the healthcare system.

RECOMMENDATIONS

- **Recommendation 1:** Amend statute to authorize a public-private partnership between the Texas Department of Agriculture and a community development financial institution, to establish a revolving loan fund for grocery stores in underserved areas of the state.
- **Recommendation 2:** Include a contingency rider in the 2014–15 General Appropriation Bill appropriating $10.1 million in General Revenue Funds to the Texas Department of Agriculture for the 2014–15 biennium for the purpose of establishing a public-private revolving loan fund with a community development financial institution.
- **Recommendation 3:** Include a contingency rider in the 2014–15 General Appropriation Bill requiring the Texas Department of Agriculture in coordination with a community development financial institution to provide a biannual report on the activities of the revolving loan fund.

DISCUSSION

The term "food deserts" originated in England and has become widely used to describe geographic areas that have a shortage of grocery stores. There is some disagreement regarding the definition of food deserts. A Tulane University report attempted to define food deserts and to examine the variation among definitions. The report found that areas

defined as food deserts in New Orleans varied from 87 percent to 17 percent of the city depending on which definition of food desert was used.

The most important criterion in describing a food desert is the distance a resident must travel to reach a grocery store. Some definitions use the distance from the central point (centroid) of a census tract to a supermarket. This is linear distance and does not measure the road distance that must be traveled to reach the grocery store. A more accurate measurement, called "network distance," accounts for the barriers, man made or natural, that determine how far one must travel to reach a grocery store. For instance, if a dwelling is only 200 feet from a grocery store it is not considered to be in a food desert but if there is a large body of water between the two and the network distance is five miles to get to the grocery store, then the house should be considered to be in a food desert.

The second criteria are the threshold or the total distance traveled. Researchers in the United Kingdom have used 1 km and 2 km (approximately 0.6 to 1.2 miles). Because many U.S. cities have large sprawl, some researchers have suggested that 2 km is a better methodology for U.S. analysis.

Traveling five miles to the grocery store may not be an inconvenience for those with vehicles, but for those who rely on public transportation, five miles may be cost and time prohibitive. Distance is not the only factor to consider. The relative wealth of the area must also be a consideration. If the census tract has a high income per household, those individuals are not at risk for being food insecure. The Tulane report threshold was a poverty rate above 20 percent, which is considered high poverty by the U.S. Census Bureau.

EFFECT OF FOOD DESERTS ON HEALTH

Geographic disparities help frame the discussion of food deserts, but to fully understand the effect of food deserts on an area it is important to look at the health demographics typical of underserved areas of low to moderate income. The Texas Health and Human Services Commission's health analysis of Texans ages 18 to 64 at or below 130 percent of the federal poverty level, which is anyone earning an income below $20,000 a year, showed that 72.1 percent of this population is overweight or obese and 9.2 percent have diabetes. A comparison group of Texans ages 18 to 64 earning between $35,000 and $50,000 a year shows that 63.4 percent are overweight or obese. It also showed that 4.4 percent have diabetes. **Figure 1** shows the comparison between each of these populations.

While the rates for individuals being overweight and having high blood pressure are a concern of all income groups, the rate of heart attack, obesity, and diabetes in Texan's with incomes below $20,000 is of particular concern. Heart attacks and strokes are the nation's leading cause of death according to the Centers for Disease Control and Prevention (CDC), and $1 out of every $6 spent on healthcare is for these two diseases. These costs are projected to grow. The CDC estimates the 2010 rate of obesity for adults in Texas was 31.0 percent while the national average was 35.7 percent.

TEXAS' FOOD DESERTS

The Food Trust, a non-profit advocacy organization working to increase the availability of grocery store in low income, low access areas, researched food deserts in detail in the Houston metro area and, more generally, for the state as a whole. The Food Trust used geographic information systems mapping software to plot locations of grocery store, amounts

FIGURE 1
PREVALENCE OF SELECTED HEALTH CONDITIONS FOR TEXANS AGES 18 TO 64 IN HOUSEHOLDS WITH CHILDREN BY ANNUAL HOUSEHOLD INCOME 2009–2010

PERCENTAGE OF SURVEY RESPONDENTS REPORTING THE FOLLOWING CONDITIONS:	ANNUAL HOUSEHOLD INCOME LEVEL			
	LESS THAN $20K	$20K TO $35K	$35K TO $50K	GREATER THAN $50K
Heart Attack	5.3%	1.5%	1.3%	0.7%
Coronary Heart Disease	2.7%	1.4%	1.5%	0.8%
Stroke	2.7%	1.3%	1.8%	0.7%
Overweight	31.8%	35.3%	30.2%	35.9%
Obese	40.3%	41.2%	33.2%	29.6%
Diabetes	9.2%	6.2%	4.4%	3.7%
High Blood Pressure	17.3%	16.9%	19.3%	17.8%

Source: Health and Human Services Commission.

spent at each market per person, and the income levels within a one-mile radius of the supermarket, to determine if people were traveling outside their neighborhoods to buy groceries. An area that has low-income population with a low volume of sales is determined to be a food desert. This determination means there is not a grocery store serving the population in that area and people are traveling to other areas to find a grocery store. The report also noted that Texas ranks the lowest of the states in grocery store per capita. The report estimated that the Houston Metro area could use 185 more grocery stores, while Texas as a whole could use 589 more grocery stores. The national average is one grocery store per 8,620 people; the Greater Houston area has one grocery store per 12,000 people.

In 2011, University of Texas Medical Branch at Galveston (UTMB) Center to Eliminate Health Disparities performed a health impact assessment for the City of Galveston. Hurricane Ike devastated a large portion of Galveston Island creating a large food desert on the east end of the island. The study also shows that of the food outlets in the food desert, many do not offer healthy food options, which further discourages healthy eating.

While no initiative can single handedly reverse the effects of poor nutrition on the population, several states have begun initiatives to reduce food deserts and bring healthier food into underserved areas.

PUBLIC-PRIVATE PARTNERSHIPS

Pennsylvania and New York have had success in encouraging small grocery stores to open in food deserts by using public-private partnerships. Both states have followed a model of working with Food Trust and community development financial institutions (CDFIs) that provide the financial management, underwriting, and determine eligibility for the small grocery stores. The U.S. Treasury defines a CDFI as a specialized financial institution that works in economically disadvantaged markets that are underserved by traditional banks. The U.S. Treasury certifies CDFIs through its CDFI Fund. Being certified is a requirement to receive financial and technical assistance from the CDFI Fund.

In 2004, Pennsylvania established the Pennsylvania Fresh Food Financing Initiative (FFFI). In cooperation with the Food Trust, and the Reinvestment Fund (TRF), a CDFI. Pennsylvania invested a grant of $10 million in 2004 with an additional $20 million over two years. As of June 2010, the $30 million investment had been matched with $146 million of additional investments. The program received 206 applicants with 93 being approved for funding. TRF awarded $73.2 million in loans and $11.9 million in grants to businesses. The approved projects are expected to create more than 5,000 jobs in the state.

The New York Legislature established the Healthy Food & Healthy Communities (HFHC) Fund in 2009 with $10 million in state appropriations. HFHC was created in partnership with TRF and the Low Income Investment Fund (LIIF) another CDFI, which has worked on projects in 26 states but primarily works on the East and West coasts. LIIF is the lead administrator for the fund and it has set specific criteria for eligibility. Applicants must satisfy a requirement that the food market is to be in a low- to moderate-income census tract and a census tract with a below average food market density. The food market must accept federal Supplemental Nutrition Assistance Program (SNAP) benefits and the Women, Infants and Children (WIC) Program (with some exceptions for mobile markets) and meet minimum retail square footage requirements. The fund has a total of $30 million from public and private investors with $26.6 million available as loans and $3.4 million available as grants. As of January 2010, $1.1 million in grants have been awarded and $1.2 million in loans have been dispersed. Of 95 applicants, seven businesses have received awards with an estimated 191 jobs created or retained.

The New Jersey Economic Development Authority (EDA) is an independent state agency that is charged to be the state's "bank for businesses" by financing small to midsize businesses. EDA partnered with TRF to establish the New Jersey Food Access Initiative (NJFAI). This $3 million initiative began in 2009. As of January 2012, NJFAI had collected approximately $18 million for investment for grocery stores in low-income and underserved areas.

PRIVATE ACTIVITIES

In summer 2011, the California FreshWorks Fund (CAFWF) was launched as a $200 million loan fund. The fund was established to finance grocery stores and other healthy food retail centers in underserved communities in California. The fund was initiated by The California Endowment, a private health foundation providing grants to community-based organizations and NCB Capital Impact, a CDFI. The CAFWF must meet a range of criteria including accepting SNAP and WIC benefits. The CAFWF also has a scoring system to qualify for assistance. Projects must score a 10 or higher and priority is given to those with higher scores.

Figure 2 shows the criteria and the points that they are worth.

ECONOMIC AND HEALTH EFFECTS OF GROCERY STORES

Grocery stores serve an important function in a neighborhood besides providing healthy fresh food. Grocery stores serve as retail anchors for neighborhoods. Businesses open near grocery stores because of the heavy traffic that the grocery stores attract. A 2006 analysis by TRF on two grocery stores in the Philadelphia area showed that not only were jobs created by operating the stores, but the construction of the stores also created jobs. The analysis concluded that the opening of the grocery stores reversed any real downward trend in property values within a half-mile radius of the store. A 2008 analysis by TRF showed that the employees of the new grocery stores tend to reside in close proximity and consumers resided within close proximity of the stores. Additionally, it reduced retail expenditure leakage into other neighborhoods resulting in a net employment increase.

UTMB conducted an evaluation of existing research and determined that the accessibility of healthy food choices correlates directly to obesity and diabetes rates, so as healthy food becomes available, rates of obesity and diabetes decline. The evaluation showed that the presence of a grocery store in a neighborhood predicts increased fruit and vegetable consumption while the rate of individuals who are overweight or obese declines. Finally, the analysis determined that the longer a person has to travel to a full service grocery store, the higher their weight.

FISCAL IMPACT OF THE RECOMMENDATIONS

A loan program is only as effective as the degree of legitimacy perceived by the potential investors and borrowers. A set of clearly delineated requirements and scoring system is an effective method to add transparency. A government entity partnering with a CDFI brings legitimacy to the fund and will bring more investors into the fund.

FIGURE 2
CALIFORNIA FRESHWORKS FUND PRIORITY CRITERIA 2011

POINTS	PRIORITY
4	(a) Within the store, product placement, pricing and promotion encourage healthy choices
4	(b) The project will create or retain quality, local jobs* in the community
3	(c) The project will create or retain quality jobs for high risk populations
3	(d) The project has community support in terms of store quality, affordability, site location, and coordination with local community plans or other programs promoting community and economic development
2	(e) If selling prepared foods, the operator provides menu labeling (funding for technical assistance on this to be provided separately by CAFWF strategic partners)
2	(f) Have at least one junk-food-free checkout aisle
2	(g) The project supports regional food systems, locally grown foods, and/or organically grown foods to the extent available
2	(h) Has location efficiency: a. In major metropolitan areas, the project promotes transit oriented development b. In areas with public transit, the project promotes access to local public transit systems c. The project is co-located with a school or clinic
2	(i) The operator chooses not to sell cigarettes
1	(j) The project involves the reuse of a historic building
1	(k) The project involves a brownfield or grayfield (as those terms are used in the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (4224 U.S.C. 9601 et seq.))
1	(l) The estimated energy consumption of the project, calculated using building energy software approved by the Department of Energy, will qualify the project for designation under the Energy Star program

*For purposes of California FreshWorks Fund (CAFWF), a quality job is a job that:
a. provides wages that are comparable to or better than similar positions in existing businesses of similar size in similar local economies;
b. offers benefits that are comparable to or better than what is offered for similar positions in existing local businesses of similar size in similar local economies; and
c. is targeted for residents of neighborhoods with a high proportion of persons of low income (as that term is defined in section 102(a) of the Housing and Community Development Act of 1974 (4224 U.S.C. 5302(a))) through local targeted hiring programs.

Source: California FreshWorks Fund.

Recommendation 1 would amend the Texas Agriculture Code to authorize the Texas Department of Agriculture to partner with a certified CDFI to establish a healthy neighborhood initiative as a public-private partnership. The certified CDFI is to be chosen by the Texas Department of Agriculture (TDA). The CDFI should be chosen based on its success in implementing other similar economic development projects, its ability to leverage additional capital, and its solvency. The awardees of the loans or grants must accept SNAP and WIC and it must be in a low to moderate-wealth census tract, or 50 percent or more of its consumers are from low to moderate-wealth census tracts.

Recommendation 2 would include a contingency rider in the 2014–15 General Appropriations Bill to appropriate $10.1 million in General Revenue Funds for the 2014–15 biennium to TDA, Strategy A.1.1 Economic Development, contingent on passage of legislation establishing the healthy neighborhood initiative. One full-time equivalent position would be added to oversee the implementation of the healthy neighborhood initiative.

Recommendation 3 would include a contingency rider in the 2014–15 General Appropriations Bill to require TDA, in coordination with the CDFI, to provide a report to the House Appropriation Committee, the Senate Finance Committee, the Governor's Office and the Legislative Budget Board no later than December 1 of every even numbered year. The report should include, but not be limited to, the number of borrowers, borrower repayment rates, total dollars loaned, total dollars awarded in grants, amount of square footage of commercial space created, the number of jobs created and/or retained, the average wages of the jobs created or retained, and additional property tax revenue gained by local entities.

FIGURE 3
FIVE-YEAR FISCAL IMPACT OF TEXAS HEALTHY NEIGHBORHOOD INITIATIVE, FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE SAVINGS/ (COST) IN GENERAL REVENUE FUNDS	PROBABLE ADDITION/ (REDUCTION) OF FULL-TIME-EQUIVALENT POSITIONS
2014	($10,056,985)	1.0
2015	($68,168)	1.0
2016	($68,286)	1.0
2017	($68,406)	1.0
2018	($68,530)	1.0

SOURCE: Legislative Budget Board.

The introduced 2014–15 General Appropriation Bill does not include any adjustments as a result of these recommendations.

REDUCE OBESITY BY AUTHORIZING A CONSUMPTION FEE ON SUGAR-SWEETENED BEVERAGES

In 2010, the Center for Disease Control estimated Texas' obesity rate to be 31 percent and states that obesity is an indicator of the risk of developing type 2 diabetes. Analysis conducted by the Institute of Medicine estimates that one out of three children born today will have type 2 diabetes in their lifetime. The Institute also estimated that the medical care costs of obese individuals are 36 to 100 times higher than their normal weight counterparts. The RAND Corporation found that merely encouraging increased consumption of fruits and vegetables without policies that decrease consumption of high calorie low nutritional value foods, such as sugar-sweetened beverages, may be politically expedient but ineffective. A policy that could reduce consumption of sugared-sweetened beverages is a consumption fee of $0.01 per ounce levied on the manufacturers of these beverages.

FACTS AND FINDINGS

- ♦ One out of three children born today will have type 2 diabetes in their lifetime. In Texas, 59 percent of individuals who have type 2 diabetes are also obese.
- ♦ According to the Center for Disease Control and Prevention, Texas' obesity rate was 31 percent in 2010.
- ♦ A $0.01 per ounce consumption fee on sugar-sweetened beverages would reduce consumption by 15 percent to 20 percent according to an analysis in a peer-reviewed medical journal.
- ♦ The Texas Medical Association estimated Texans spent $15.6 billion in 2011 for all costs related to obesity. These expenditures are projected to be $39 billion by 2040.

CONCERNS

- ♦ Individuals who consume sugar-sweetened beverages have a higher caloric intake than those who do not consume such beverages. Half of all discretionary calories can be directly attributed to sugar-sweetened beverages.
- ♦ The medical costs of overweight individuals are 10 percent to 20 percent higher than their normal weight counterparts. The medical costs for obese individuals are 36 percent to 100 percent higher than their normal weight counterparts.

RECOMMENDATIONS

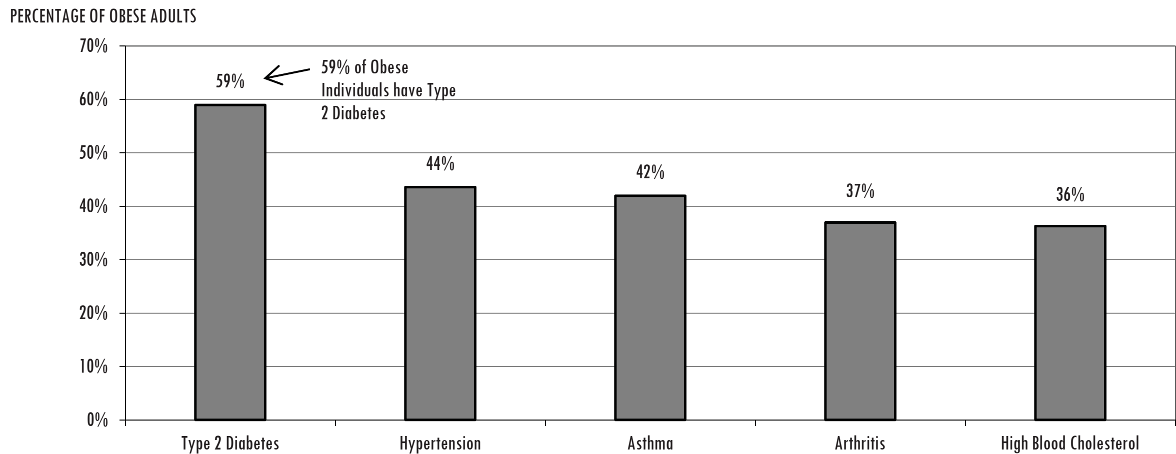
- ♦ **Recommendation 1:** Amend statute to levy a $0.01 per ounce consumption fee on bottlers of sugar-sweetened beverages and deposit the revenue in the General Revenue Fund. It is recommended that a portion of this revenue be dedicated to programs or grants designed to treat, reduce, or prevent obesity.
- ♦ **Recommendation 2:** Include a contingency appropriation rider in the 2014–15 General Appropriations Bill to appropriate $1.2 million in General Revenue Funds and 16 full-time-equivalent positions each fiscal year of the biennium for the Comptroller of Public Accounts to administer the consumption fee.

DISCUSSION

The Center for Disease Control and Prevention (CDC) in 2000 estimated 23.1 percent of Texans were obese. To be obese an individual's weight to height ratio must be over 30 which is considered unhealthy. By 2010 the estimate increased to 31.0 percent. These figures do not include individuals who are overweight and on the verge of becoming obese. In 2003, CDC estimated Texas spent $5.3 billion for direct medical costs for obesity. The Texas Medical Association estimates that Texans spent $15.6 billion in 2011 for all costs, including indirect costs, related to obesity. By 2040, expenditures are projected to be $39 billion, a 150 percent increase. The Texas Department of State Health Services health survey shows that adults who are diagnosed with obesity typically have other co-morbid conditions. Fifty-nine percent of obese adults have diabetes, 43.6 percent have hypertension, and 36.3 percent have high blood cholesterol. The trends in obesity and healthcare are not sustainable for Texas' healthcare system. **Figure 1** shows the prevalence of obesity among adults by co-morbid conditions.

In May 2012, the Institute of Medicine (IOM) published a comprehensive study on the trends, effects, and costs of obesity in America. The report states that one out of three children born today, and one out of two African-American and Latino children will have type 2 diabetes in their lifetime.

FIGURE 1
PREVALENCE OF OBESITY AMONG ADULTS BY CO-MORBID CONDITIONS
FISCAL YEAR 2010



Source: Texas Department of State Health Services.

Recent publications show more children are experiencing what were typically considered adult diseases such as type 2 diabetes, hypertension, and sleep apnea due to excessive weight. The medical care costs for overweight individuals are 10 to 20 percent higher. The IOM cited a 2009 study that estimates childhood obesity is responsible for $14.1 billion in direct medical cost in the U.S. The IOM report states that if no Medicaid client was obese spending would be 11.8 percent lower. Individuals who are obese have life spans that are 1 to 13 years shorter than normal weight individuals.

EFFECTS OF SUGAR-SWEETENED BEVERAGES ON CALORIE CONSUMPTION

Sugar-sweetened beverages include all fountain, bottled, or canned beverages with added sweeteners derived of cane sugar, corn sugar, honey, and other sweeteners whose addition add significant calories; this excludes alcoholic beverages. The RAND Corporation, a non-profit research center, conducted a research study in 2010 examining the effect of a tax on sugar-sweetened beverages. The report concluded that for a tax to be an effective deterrent to consumption, it must be substantially greater than 4.2 percent, which is the average sales tax that states charge for discretionary food. RAND found that higher taxes would have a significant effect in reducing consumption of carbonated beverages, which were the only type of beverage analyzed. The paper also warned that if reducing consumption is the goal, rather than just collecting money, it must be tied to consumption. Essentially, it cannot be a flat fee charged to retailers or producers, but rather must be tied to the amount consumed. RAND estimated that an 18 percent tax proposed by New York's Executive Board would produce a 20 percent reduction in consumption.

In a separate study in 2009, RAND analyzed the effect of location on consumption of calories in Los Angeles County by measuring discretionary calories. The U.S. Department of Agriculture defines discretionary calories as calories above what is needed for a healthy diet. East Los Angeles residents had significantly higher rates of obesity. More of the calories consumed by East Los Angeles residents were from salty snacks, cookies, candy, sodas, and alcohol. Half of all the discretionary calories were attributable to sodas.

A more thorough study of Los Angeles and South Louisiana residents was conducted to predict the consumption of discretionary calories. The study found that the overconsumption of discretionary calories is much greater than the under consumption of fruits and vegetables among the two communities. Residents had similar consumption rates of fruits and vegetables. These findings show discretionary calories are a significant factor in the obesity epidemic. RAND concluded that policies only encouraging fruit and vegetable consumption are politically expedient but are ineffective. The study concluded that to have significant impact, policies to curb the consumption of junk foods and sweetened beverages should be implemented.

A study published in 2007 in the *American Journal of Public Health* did a meta-analysis of 88 studies that looked at the effects of sugar-sweetened beverages (SSBs) and health outcomes. SSBs include carbonated sodas and diet sodas, fruit juices that are not 90 percent fruit juice, ready to drink coffees and teas, energy drinks, sports drinks, and flavored water. The report finds that individuals that consume SSBs have significantly increased calorie intake compared to those who do not consume SSBs. These calories are not compensated with more activity by consumers so weight gain is the inevitable outcome unless there is a reduction in consumption. One finding of note was in a study that tracked 91,249 women over eight years. The study found women who consumed one or more servings of a soft drink per day had double the risk for developing type 2 diabetes. The overall conclusion was that the entire population needs to reduce consumption of SSBs.

ESTIMATING THE IMPACT OF A CONSUMPTION FEE

An analysis by the Rudd Center for Food Policy at Yale University, in 2008, estimated that for every 10 percent increase in price, consumption of SSBs decreases by 7.8 percent. The SSB industry's own analysis showed that a comparatively lower 6.8 percent increase in pricing resulted in a consumption decrease of 7.8 percent. Government has used taxation as a way to discourage use of tobacco products, a similar structure on SSBs consumption could curb the rise of obesity and its related co-morbid conditions. An analysis in the *New England Journal of Medicine,* in 2009, recommended an excise tax paid by the manufacturers and wholesalers. The analysis discouraged the use of a sales tax, because a sales tax is applied at the register after the consumer has decided to purchase the product. Because a sales tax is based on the total sale, consumers will buy cheaper brands instead of lowering consumption. A consumption fee can be based on total ounces meaning that the 12-ounce store brand and name brand will be charged the same rate (see **Figure 2**). Additionally, a consumption fee on the bottlers is easier to collect than a sales tax at the retailer because fewer entities will be required to pay the tax. An analysis in the journal *Preventative Medicine*, in 2011, provided a methodology and analysis of how to calculate the economic impact of imposing a $0.01 per ounce consumption fee. The analysis concluded one cent per ounce tax would increase the cost of a 20-ounce beverage by almost 20 percent and reduce consumption of all SSBs including diet beverages 16.3 percent. If diet beverages were excluded, the overall reduction of SSBs would be 24 percent. As with any other fee in which the dollar value is set in statute, its value eventually decreases unless it is indexed for inflation. The consumption fee could be indexed for inflation so that the effectiveness of the reduction strategy is consistent over time. The Rudd Center for Food Policy developed an online calculator for calculating revenue from a consumption fee. The calculator estimates Texas would receive approximately $1,100.6 million in fiscal year 2014, if in effect for the full fiscal year, and $1,105.7 million in fiscal year 2015 by imposing a $0.01 per ounce consumption fee on naturally and artificially sweetened beverages. **Figure 3** shows the estimated five-year fiscal impact assuming collections begin January 1, 2014.

FIGURE 2
EFFECT OF CONSUMPTION FEE ON PRICES

BEVERAGE SIZE	CONSUMPTION FEE
12 oz Soda Can	$0.12
1 liter Bottle	$0.33
64 oz Fountain Drink	$0.64
6 Pack of 12 oz Soda Cans	$0.72
3 liter Bottle	$1.01
12 pack of 12 oz Soda Cans	$1.44

Source: Legislative Budget Board.

APPLYING LESSONS LEARNED FROM TOBACCO TO SUGAR-SWEETENED BEVERAGES

Government entities have used taxation as a way to discourage use of tobacco products through the use of a per unit tax or as a percentage of the total sale. These "sin" taxes have reduced consumption as shown by at least 100 studies. The conclusions point to the basic economic law that as price increases demand decreases. This is referred to as price elasticity where the change in price affects consumption. Cigarettes have a price elasticity of -.25 to -.50. Which means that with a 10 percent increase in price, consumption will decrease 2.5 percent to 5.0 percent. A large focus of tobacco prevention was using taxation to discourage teenage and young adult consumption by preventing initiation and later addiction. Multiple studies have shown that certain subgroups, the less educated, lower-income, and lower socio-economic classes of the population are more sensitive to changes in prices.

The question of how dangerous obesity is compared to use of tobacco has been asked widely. Another RAND study showed that obesity has as strong or even a stronger association with chronic medical conditions than smoking. The study also showed that a larger percentage of the U.S.

FIGURE 3
FIVE-YEAR FISCAL IMPACT OF TAXING SUGAR-SWEETENED BEVERAGES, FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE REVENUE GAIN/(LOSS) TO GENERAL REVENUE FUNDS	PROBABLE SAVINGS/(COST) TO GENERAL REVENUE FUNDS	CHANGE IN FULL-TIME-EQUIVALENT POSITIONS COMPARED TO 2012–13 BIENNIUM
2014	$642,024,365	($1,200,000)	16.0
2015	$1,105,745,852	($1,200,000)	16.0
2016	$1,114,304,325	($1,200,000)	16.0
2017	$1,122,929,041	($1,200,000)	16.0
2018	$1,131,620,511	($1,200,000)	16.0

Source: Legislative Budget Board.

population is obese compared to the percentage that is poor, heavy drinkers, or daily smokers, providing even stronger evidence that obesity should become a higher national priority. The study was conducted in 2001 and since that time obesity has increased nationwide making the estimated prevalence of chronic medical conditions higher while the rates of smoking have decreased.

POLICY OPTIONS FOR USING THE CONSUMPTION FEE REVENUE

A consumption fee on sugar-sweetened beverages will not in itself cure the obesity epidemic but would provide funding for several initiatives that, in conjunction with one another, can slow and, if implemented correctly, reverse the course of obesity. In general, the culprit of the obesity epidemic is excessive calories consumed tied with lack of physical activity. One option is to establish an incentive to healthcare providers to offer weight management counseling and nutritional counseling to participants. Other options include the establishment of public private partnerships to attract grocery stores which has been shown by The University of Texas Medical Branch at Galveston to reduce the rates of obesity in the surrounding area; as well as increasing obesity awareness campaigns and education programs in schools and communities.

FISCAL IMPACT OF THE RECOMMENDATIONS

To curb the obesity epidemic it is recommended that the Texas Tax Code be amended to impose a $0.01 cent per ounce consumption fee on sugar-sweetened beverages that is indexed yearly for inflation on bottlers and the fee be deposited in the General Revenue Fund. It is estimated this will generate $642.0 million in fiscal year 2014 and $1,105.7 million in fiscal year 2015. The fiscal year 2014 estimate assumes the proposal would be enacted January 1, 2014 but collections would begin February 1, 2014. There would be administrative costs at the Comptroller of Public Accounts. The fiscal note for Senate Bill 1004, Eighty-second Legislature, Regular Session, 2011, which proposed a similar tax structure estimated $2.4 million in administrative cost for the biennium. It is recommended that a portion of this revenue be dedicated to programs or grants designed to treat, reduce, or prevent obesity.

Recommendation 2 would include a contingency rider in the 2014–15 General Appropriations Bill that would appropriate $1.2 million in General Revenue Funds for each fiscal year of the biennium to the Comptroller of Public Accounts' Revenue and Tax Proceedings Strategy, to administer the fund with 16 full-time-equivalent positions for processing applications and forms for the new consumption fee.

The introduced 2014–15 General Appropriation Bill does not include any adjustments as a result of these recommendations.

OVERVIEW OF THE TEXAS MOVING IMAGE INDUSTRY INCENTIVE PROGRAM

The Texas Moving Image Industry Incentive Program provides publicly funded grants to film, television, commercial, and video game productions. The intent of these grants is to bring these productions to Texas and increase local employment, tax revenues, and private spending in the state.

Two recent studies evaluated the Texas incentive program. Each noted several strengths in the design of the program compared to incentive programs in other states. One evaluation found the Texas program more efficient than similar incentives in other states in terms of direct costs and jobs created. The other evaluation, by the Comptroller of Public Accounts, found that the Texas program is inefficient in its allocation of incentive awards.

FACTS AND FINDINGS

- ♦ Most states have an incentive program intended to attract film, television, commercial, and/or video game productions with the expectation that they will increase local employment, tax revenues, and private spending.
- ♦ Nationally, these incentive programs offer either tax credits for or direct payment to eligible productions.
- ♦ Texas offers two types of grants to eligible productions. The first would reimburse the production for up to 25 percent of eligible wages paid to Texas residents. The other option is for a grant for up to 15 percent of eligible in-state spending.
- ♦ Compared to other states, Texas has relatively strict guidelines for its incentive awards. These guidelines include making incentive payments only at the end of a production and only to reimburse a production's in-state spending or hiring. Texas also differs from other states in that its awards are not transferable.
- ♦ Evaluations of publicly funded incentives for the entertainment industry reported varied conclusions about these incentives' outcomes.
- ♦ The film and television sectors also benefit from a sales tax exemption on tangible personal property used in a production. Film productions are also eligible for the permanent resident exemption available to all guests who occupy a hotel for 30 days or more.
- ♦ Several states have either suspended or capped incentive programs in order to balance their budgets.

DISCUSSION

Texas, like most states, has a publicly funded incentive program intended to attract film, television, commercial, and video game productions to the state. The rationale for these incentive programs is that film, television, commercial, and video game productions will increase local employment, tax revenues, and private spending within the state.

The Texas program, the Texas Moving Image Industry Incentive Program (TMIIIP), is administered by the Texas Film Commission (TFC), one of the Trusteed Programs within the Office of the Governor. The TFC was established in 1971 to encourage the development of the state's film industry. In addition to overseeing the state's incentive program, TFC assists filmmakers by providing information on statewide film locations, sales tax exemptions, local housing options for film and television productions, and by maintaining a list of qualified vendors and crew.

The Seventy-ninth Legislature, Regular Session, 2005, passed legislation that established the first version of the incentive, called the Film Industry Incentive Program. The intent of this program was to provide grants for production companies that filmed in Texas. The program did not receive an appropriation for the 2006–07 biennium.

The Eightieth Legislature, 2007, amended the grant program to include other types of filmed entertainment, including video games, and renamed the program as the Moving Image Industry Incentive Program. The program received an appropriation of $22 million in General Revenue Funds for the 2008–09 biennium.

The Eighty-first Legislature, Regular Session, 2009, amended the program again to make it more competitive with industry incentives offered by other states. The most significant changes included a lower spending threshold for qualification and a higher cap on grant awards. For the 2010–11 biennium, the Legislature appropriated $22 million in General Revenue Funds and an additional $40 million in General Revenue

Funds through Article IX of the General Appropriations Act to fund the program.

The program received an appropriation of $32 million in General Revenue Funds for the 2012–13 biennium.

TEXAS INCENTIVE PROGRAM REQUIREMENTS AND BENEFITS

Film, television, commercial, and video game productions are all eligible for incentives through the TMIIIP. If a production meets the eligibility criteria, it may apply to TFC for one of two types of grants. The first would reimburse the production for up to 25 percent of eligible wages paid to Texas residents. The other option is for a grant of up to 15 percent of eligible in-state spending for film, television show, and video game productions. Commercials are eligible for grants up to 5 percent of in-state spending. Productions that film in an underutilized or economically distressed part of the state are eligible for an additional 2.5 percent reimbursement of total in-state spending.

To qualify for benefits, at least 60 percent of a production must be filmed in Texas. At least 70 percent of its crew, cast, and extras must be Texas residents (meaning they lived in Texas since at least 120 days before the first day of principal photography) unless TFC determines that a sufficient number of qualified cast or crew are not available in the state. Eligible films or television programs must spend at least $250,000 in the state to be eligible for reimbursement; commercials and video games must spend at least $100,000.

In-state spending on wages over $1 million for an individual is not eligible for incentive payments. Under some circumstances, the state may cancel or deny incentive payments. For instance, the state is not required to make payments to a production that portrays Texas or Texans in an unflattering or negative light.

TFC preliminarily approves eligible applicants before production begins. Once filming is complete, the production submits documentation of spending to TFC. This documentation includes:

- a master ledger reporting all eligible Texas spending;
- a payroll spreadsheet, sorted alphabetically by name, that reflects payments made to Texas residents and includes copies of payroll company invoices and registers that detail wages and fringe benefits paid to Texas residents;
- a complete cast list, including Texas residents and non-residents;
- a copy of each Texas resident's Declaration of Texas Residency Form;
- copies of call sheets, as well as location maps and production reports;
- a vendor list; and
- a copy of the final content of the project (including shooting script and DVD copy of the movie, television show, or commercial).

TFC and officials with the Office of the Governor each review the documentation before any incentive payments are made.

TFC uses a multiplier for each type of production to convert reported jobs (which may only last a few months) into full-time equivalents (FTEs), which assumes a 2,000 hour, 50-week work year. For example, television commercial productions, which are assumed to have a 3.5-day duration with 12-hour workdays, need to hire 47.3 crew members to equal one annualized FTE. TFC uses different multipliers for film, television, and video game productions.

Before fiscal year 2012, the incentive program had awarded grants on a first–come-first-served basis. In January 2012, TFC adopted new rules that make applications subject to additional considerations, including:

- proposed spending on existing state production infrastructure (such as soundstages and industry vendors);
- the number of jobs estimated to be created by the project;
- the project's ability to promote Texas as a tourist destination by its spending;
- the magnitude of the estimated expenditures; and
- whether the project will be directed or produced by a Texas resident.

In addition to the benefits offered by TMIIIP, film and television productions benefit from a sales tax exemption on tangible personal property used in a production. Film productions are also eligible for the permanent resident exemption from the Hotel Occupancy Tax available to all guests who occupy a hotel for 30 days or more.

TEXAS COMPARED TO OTHER STATES

Most states have an incentive program for the entertainment industry. Typically, the incentive takes the form of a tax credit. Approximately one-third of the states with incentives, including Texas, make direct payments to productions, such as grants or rebates on qualified spending. Although the structures of the incentives fall into these two broad categories, there are a number of distinctions between state incentive programs.

For instance, Texas reimburses productions only for their in-state spending while some states, including Connecticut, Massachusetts, and Michigan, reimburse production and salary costs incurred outside the state.

Incentive rates differ across state programs. The Texas program awards grants up to 15 percent of total in-state spending, or up to 25 percent of Texas wages. At least 17 states (including Alaska, Florida, Illinois, Louisiana, Missouri, New Mexico, New York, Michigan and Oklahoma) offer tax credits or rebates worth 20 percent to 40 percent of in-state spending.

The Texas program also awards grants directly to the productions after they have documented their in-state spending. In states that offer tax credits, an entity other than the film or television production may ultimately redeem the credit. Some states will refund tax credits a production does not use; for instance, if a production's total tax liability is less than its tax credits. Connecticut, Massachusetts, Michigan, Alaska, California, Florida, Indiana, Illinois, New York, and Louisiana are among the states that offer transferable or refundable tax credits.

While some states award incentives without an annual cap, the Texas program has always limited awards to appropriated amounts.

ANALYSIS OF THE TEXAS INCENTIVES

The Comptroller of Public Accounts (CPA) and the IC^2 Institute, a business incubator and interdisciplinary research unit of the University of Texas at Austin, have recently evaluated the Texas Moving Image Industry Incentive Program.

In its analysis from April 2011, IC^2 concluded, based on the state's relatively low reimbursement and cost-per-direct-job rates, that the Texas incentive program is among the country's most efficient and effective.

The IC^2 report uses TFC data from between June 26, 2007 and December 31, 2010 that attributes 6,519 full-time-equivalent production jobs to approximately $58.1 million in state incentive spending. In-state spending by grant recipients was approximately $598.3 million. The IC^2 report estimated that each FTE attributed to the incentives cost the state approximately $8,916. Costs-per-job-created for individual sectors of the moving image entertainment industry were:

- feature films—$13,198;
- television programs—$10,242;
- television commercials—$11,113; and
- video games—$4,518.

The cost-per-job figures estimated by IC^2 for Texas are lower than most estimates that come from other states. However, the report authors caution that there are differences in program design, data collection, and jobs-counting methodology across the states.

More recent TFC data, covering September 1, 2009 through May 31, 2012, show 6,722 full-time equivalent jobs resulting from approximately $61.8 million in state incentive spending. In-state spending among the grant applicants was approximately $481.8. The cost to the state of each full-time equivalent was approximately $9,185. **Figure 1** shows the in-state spending and grant awards for individual sectors of the moving image entertainment industry between September 1, 2009 and May 31, 2012.

Analysis from CPA (published in December 2010) cited strengths of the Texas program, including its focus on in-state spending, its inclusion of the video game industry, and that it offers opportunities to show Texas in a positive light. This report identified several program weaknesses, including that production jobs tend to be short-term and leave the state upon completion of production. They also found that projects receiving benefits tend to be highly concentrated in just a few counties. Using data from late April 2009 through August 2010, the report found that:

- in 17 counties, incentives were awarded to one production;
- in 8 counties, between 2 and 10 productions received incentive awards;
- two counties (Dallas and Travis) had between 11 and 100 productions receiving incentive awards; and

FIGURE 1
TEXAS FILM COMMISSION DATA ON MOVING IMAGE INDUSTRY INCENTIVE PROGRAM SPENDING SEPTEMBER 1, 2009 TO MAY 31, 2012

	NUMBER OF PRODUCTIONS	FTE PRODUCTION JOBS	TEXAS SPENDING BY PRODUCTIONS	GRANT SPENDING BY TFC	GRANT SPENDING PER FTE
Film	39	1,017	$119,105,892	$18,399,726	$18,092
TV	35	3,614	$144,999,370	$28,803,301	$7,970
Commercials	206	171	$40,918,753	$2,590,241	$15,148
Video Games	74	1,920	$176,737,841	$11,945,223	$6,221
Total	**354**	**6,722**	**$481,761,856**	**$61,738,491**	**$9,184**

Sources: Legislative Budget Board; Texas Film Commission.

- 227 counties did not have a production receiving an incentive award.

The CPA's report also found that entertainment industry sectors do not receive grants in proportion to their performance. For instance, of the 260 applications approved from April 2009 to August 2010, the video game sector was responsible for 41 percent of the Texas spending and 45 percent of in-state hiring, though it received only 19 percent of the grant awards. Television productions accounted for 32 percent and 34 percent of spending and hiring, respectively, and received 51 percent of grant awards. Film productions accounted for 18 percent of in-state spending, 18 percent of the FTEs, and 26 percent of grant awards. Commercials represented 9 percent of spending, 3 percent of hiring, and 4 percent of grant awards.

The CPA's report also used economic modeling software to estimate the effective state and local sales tax rates for the film and video game sectors as 4.66 percent and 7.61 percent, respectively. Using these rates and TFC's industry spending data from September 1, 2009, to May 31, 2012, film and video game productions receiving grant awards generated approximately $5.6 million and $13.4 million, respectively, in sales tax revenue.

The CPA's report included recommendations that the amount of incentive awards be tied to either an industry sector's performance or its effective sales tax rate. The TFC's new rules adopted in January 2012 addressed this recommendation by raising the incentives available to video game productions from 5 percent to 15 percent, giving video games productions parity with films and television shows.

EVALUATION OF INCENTIVES IN OTHER STATES

Several other states have evaluated their incentives for the entertainment industry. Although state incentive programs differ in their design and benefits, there is no apparent correlation between an incentive's structure (tax credit vs. direct payment) and the conclusions of the evaluation.

Evaluations that generally favor the incentives usually emphasize economic modeling estimates showing a return on investment (in the form of state tax revenues) when direct and indirect effects are considered. Evaluations critical of incentives focus on the immediate net loss to the state budget, the high cost of subsidized jobs, and/or the opportunity cost of the incentives.

Reports on Connecticut and Pennsylvania's production tax credits are representative of evaluations favoring the incentives.

From 2006 to 2009, Connecticut's film production tax incentive was worth an average of $40 million per year. Connecticut reported in December 2010, that the incentive program netted the state approximately $1 million each year (in payroll tax revenues and local economic activity) above their forecast for what would have happened without the program, assuming all newly created jobs are full-time and permanent.

In May 2009, a consulting firm released a report on Pennsylvania's production credit that covered fiscal years 2007 and 2008. The report acknowledged a net fiscal loss when comparing direct effects (the cost of the program compared to the tax revenue generated by productions receiving incentives), but estimated a net fiscal gain of $4.5 million when considering all of the revenues generated by the industry. The report does not specify these non-tax sources of revenue.

Reports that are skeptical of the value of incentives are typified by evaluations of tax credits in Massachusetts and Michigan. In a January 2011 report, the Massachusetts

Department of Revenue used a microsimulation model to show that the tax credit did result in production jobs for the state, but those job gains were "offset by the job losses due to state spending cuts to maintain a balanced budget."

A September 2010 report by the Michigan Senate Fiscal Agency found the increased private sector activity resulting from the incentives came at the cost of other public expenditures. It concluded that the incentive would not pay for itself from a revenue standpoint, even when considering the generation of additional economic activity that would not have otherwise occurred.

RECENT CHANGES IN OTHER STATES

At least four states have scaled back or suspended their film production incentive programs recently, these states include:

- Michigan—although the state's tax credit of up to 40 percent of in-state spending had been operating without a cap since its inception, beginning in fiscal year 2012 it will have an annual $25 million budget;
- New Mexico—as of fiscal year 2012, the state will cap its 25 percent spending rebate at $50 million annually;
- Washington—the state's incentive program, which awarded spending rebates to productions worth up to 30 percent of their in-state spending, expired in 2010. A bill to renew it failed during the state's 2011 legislative session; and
- Arizona—the state's 20 percent tax credit expired in 2010, following a state Department of Commerce report that found the program to be a net loss for the state's budget during calendar year 2009. A bill to renew the program through 2041 failed to pass in 2011, but has been re-introduced for the 2012 legislative session.

OVERVIEW OF VETERANS' EMPLOYMENT CHALLENGES AND RESOURCES IN TEXAS

Shifting from military to civilian life can pose serious challenges for veterans. Many veterans experience difficulties such as selecting a career, finding a job, accessing veterans' benefits, and adjusting to the civilian world. Finding meaningful employment is something many veterans view as their most significant obstacle. While veterans may have unique needs, many resources in Texas can assist them in their efforts to find employment.

Both the federal and state government, and private for-profit and non-profit entities, offer employment services to assist veterans. Employers have made efforts to hire more veterans, as indicated by the fact that from September 2011 to September 2012, veterans had greater success in finding a job than in the past. As more military service members return from the conflicts overseas and acquire veteran status, however, employment resources will remain a priority.

FACTS AND FINDINGS

- ♦ The unemployment rate for all Texas veterans, from September 2011 to September 2012, decreased from 8.2 percent to 5.8 percent, and the nationwide unemployment rate for post-9/11 (Gulf War II) veterans decreased from 11.7 percent to 9.7 percent.
- ♦ In a 2011 nationwide survey of veterans, 60 percent indicated that explaining how their military experience translated into skills that would interest a civilian employer was a significant barrier to employment.
- ♦ All branches of the military offer transition assistance to exiting service members so they can find civilian employment.
- ♦ Through Texas Veterans Commission and local workforce solution center staff, veterans can find free career development and job search services.
- ♦ Texas Veterans Commission staff located throughout the state conduct outreach to employers to open new job opportunities for veterans, and provide guidance to help veterans become employable, especially those with barriers to employment such as a disability or homelessness.
- ♦ The Texas Workforce Commission's Veterans Leadership Program offers information and referral services to post-9/11 veterans by directing them to employment, training, medical care, mental health and counseling services.
- ♦ A variety of other resources offered by the private sector, such as web-based job boards, military recruiting firms, career fairs, and public sector programs, such as financing to start a business and tax incentives to hire veterans, can open opportunities for veterans to start new careers.

DISCUSSION

Either by using employment services (public and/or private sectors) or without any assistance, Texas veterans found more success in obtaining a job from September 2011 to September 2012 than they did in the prior year. As **Figure 1** shows, unemployment rates decreased significantly for all Texas veterans, as well as for veteran demographic groups nationwide.

FIGURE 1
UNEMPLOYMENT RATES FOR UNITED STATES VETERAN DEMOGRAPHIC GROUPS AND ALL TEXAS VETERANS SEPTEMBER 2011 TO SEPTEMBER 2012

GROUP	2011	2012
All Texas Veterans	8.2%	5.8%
All United States Veterans	8.1%	6.7%
United States Veterans Age 18 to 30	19.3%	12.9%
United States Gulf War II Veterans	11.7%	9.7%

NOTE: Unemployment rates are not seasonally adjusted.
SOURCES: Legislative Budget Board; U.S. Bureau of Labor Statistics.

The unemployment rate for all Texas veterans decreased from 8.2 percent to 5.8 percent from September 2011 to September 2012. Reliable monthly data for Texas specific veteran demographic groups does not exist; but nationwide, the unemployment rate for post 9/11 (Gulf War II) veterans decreased from 11.7 percent to 9.7 percent. The unemployment rate for veterans age 18 to 30 also fell during this period: from 19.3 percent to 12.9 percent. All veterans

nationwide experienced an unemployment rate decrease from 8.1 percent to 6.7 percent.

According to a 2011 study by Prudential Financial, new veterans transitioning from military to civilian life face challenges such as finding a job, navigating the complex system of veterans benefits, making decisions about the next phase of their lives, and adjusting to the civilian world. The study also found that finding employment is their greatest concern. Although the job market for veterans in Texas is improving, the future return of service members from Iraq and Afghanistan and the transition to civilian life will continue to make access to effective career development and job search services important.

MILITARY TO CIVILIAN SKILLS TRANSITION

Research indicates that a key barrier to employment for veterans is the challenge of translating experience and skills gained during military service to ones that are understood by employers. In a Prudential Financial survey of veterans conducted during calendar year 2011, 60 percent cited that explaining how their military experience translates to skills of interest to a civilian employer was a significant barrier to employment. Veterans responded in the survey that the skills translation factor was the second most significant challenge in finding a job, after the "current economic condition."

The *Veterans Talent Index* report issued in May 2012 by Monster Insights found that, based on employer survey results, veterans need to focus on translating military skills to corporate ones, and use civilian language in resumes when identifying military skills and accomplishments. Also, companies interviewed in 2012 by the Center for New American Security cited the problem of skill translation more often than any other obstacle for employing veterans. Many employers indicate that veterans do not describe their skills and expertise in ways that make them relevant to civilian companies. Also, companies may not be aware of the military skills that are important, or be familiar with military jobs.

Use of web-based military skills translators, such as the federal O*NET, can identify careers associated with a military occupation. While these are useful tools, they do not provide counseling to veterans on how to draft their resume or present themselves at a job interview in a way that clearly shows how their military experience makes them qualified for a particular position. Assistance from Texas Veterans Commission (TVC) employment representatives and workforce solution center staff can provide the specifics of how military skills should be presented in a resume or discussed with employers in way they will understand. Veterans who use these free resources will be in a better position to communicate the details of their military background and find employment.

MILITARY TO CIVILIAN EMPLOYMENT TRANSITION PROGRAMS

Although their organization and procedures vary, every branch of the military offers transition assistance services to individuals separating from military service. Transition assistance offices are located on military installations in the U.S. and overseas. For example, at Fort Hood, the Army Career and Alumni Program provides transition assistance to soldiers who are separating from active duty.

In general, transition services include pre-separation counseling, a Transition Assistance Program workshop, the U.S. Department of Veterans Affairs (VA) benefits briefing, and a Disabled Transition Assistance Program class. The components of these services and programs are shown in **Figure 2**. It should be noted that beginning in 2013, a more extensive transition program, Transition GPS, will be gradually phased-in to replace the Transition Assistance Program. All exiting services members will be required to attend the new program's five-day seminar covering topics such as translating military skills into civilian ones, attending college, and starting a business.

In addition to these services, transition assistance offices at military installations provide career development counseling, job search services, and occupational skills training. These services are supplemented by the Army and Navy's Credentialing Opportunities Online programs that help service members find civilian credentials related to their military occupational specialty. Also, the U.S. Department of Defense's Turbo Tap website provides information about career development, finding employment, relocation assistance, healthcare, education, and other transitions related topics.

Finally, the U.S. Army National Guard's Job Connection Education Program (JCEP) staff assists National Guard and Reserve service members and their spouses find careers. JCEP staff help program participants develop a plan for transferring skills gained in the military to a civilian job setting, and understand and master key job-search resources and services for obtaining employment. The U.S. Army National Guard chose Texas as the first site for JCEP, which has offices in Texas National Guard facilities at Fort Worth, Houston, and Austin.

FIGURE 2
TRANSITION ASSISTANCE SERVICES/PROGRAMS AS OF 2012

SERVICE/PROGRAM	COMPONENTS	FEDERAL ENTITY
Pre-separation counseling	Immediate and long-range career guidance, identify relocation resources, benefits counseling, and referrals to other service provider.	Every military branch
Transition Assistance Program	Workshops to educate service members about job searches, career decision-making, labor market conditions, resume writing, and job interview techniques.	Every military branch, U.S. Department of Defense
Benefits Briefing	Sessions cover Department of Veterans Affairs benefits and Montgomery GI Bill education program.	U.S. Department of Veterans Affairs
Disabled Transition Assistance Program	Class provides specialized vocational rehabilitation and employment information.	U.S. Department of Veterans Affairs

NOTE: Beginning January 2013, a more extensive version of TAP will be gradually phased-in nationwide.
SOURCE: Legislative Budget Board.

PRIVATE SECTOR SERVICES

In addition to the private career counselors and employment agencies used by the general public, many firms focus on assisting veterans and service members seeking a career outside the military. Military recruiting firms, such as Bradley-Morris, provide job placement services for transitioning military. Other organizations, both for-profit and non-profit, offer web-based services such as job boards that allow veterans to search for openings by job categories and location, and post their resumes online for employers to browse.

FEDERAL GOVERNMENT WEB-BASED SERVICES

The federal government also provides employment information websites for veterans. For example, the FedsHireVets website helps veterans identify and apply for job opportunities in federal government agencies. Other websites offer career development and job search functions for employment in the private sector, such as Career One-Stop.

STATE GOVERNMENT VETERANS EMPLOYMENT PROGRAMS

State agencies offer additional support to help veterans find employment in Texas. The Texas Coordinating Council for Veterans Services, the Texas Veterans Commission, the Texas Workforce Commission, and the Department of Assistive and Rehabilitative Services are engaged in efforts to assist veterans.

TEXAS COORDINATING COUNCIL FOR VETERANS SERVICES

Senate Bill 1796, Eighty-second Legislature, Regular Session, 2011, established the Texas Coordinating Council for Veterans Services to coordinate the activities of state agencies that assist veterans; coordinate outreach efforts that ensure veterans are made aware of services available to them; and facilitate collaborative relationships among state, federal, and local agencies and private organizations to identify and address issues affecting this population.

As also required by the legislation, the Council issued a report in October 2012 that identified veteran needs in areas such as employment, and made recommendations to address them. Recommendations of the Council's employment workgroup seek to increase employment of veterans in state agencies, educate employers on the benefits of hiring veterans, and support initiatives to develop veterans-owned businesses.

TEXAS VETERANS COMMISSION – VETERANS EMPLOYMENT SERVICES

Veterans have access to state employment programs through the Texas Veterans Commission (TVC), Veterans Employment Services (VES) program. VES staff are located in local workforce solution centers, VA medical facilities, Brooke Army Medical Center, and military installations. The majority of the VES staff, 163, serve veterans in workforce solution centers. Workforce solution centers are overseen by local workforce development boards. There are 201 workforce solution centers throughout the state.

TVC uses two types of employees to serve veterans seeking employment, Disabled Veteran Outreach Program (DVOP) specialists and Local Veterans Employment Representatives (LVER). DVOP specialists provide intensive services to disabled veterans and/or those with significant barriers to employment, such as homelessness. Intensive services include: an assessment of skills and abilities, career coaching, and development of an individual employment plan that

identifies employment goals, interim objectives, and appropriate services. As of October 2012, 79 DVOPs were located in 55 local workforce solution centers throughout the state. An additional 10 DVOPs were also assigned to Brooke Army Medical Center, U.S. Department of Veterans Affairs medical facilities, military installations, and the American GI Forum office in conjunction with two federal programs: Vocational Rehabilitation and Employment program (VR&E), and the Recovery and Employment Assistance Lifelines program (REALifelines).

The VA's VR&E program offers vocational rehabilitation and counseling services to injured service members and veterans with service-connected disabilities. DVOPs located at VA medical facilities in Temple, Dallas, Houston, and San Antonio provides intensive services to veterans referred by the VR& E program. The REALifelines offered employment services to seriously injured service members, and was coordinated by the U.S. Department of Labor (DOL) at the national level. According to TVC, DOL will no longer provide funding for this program after December 2012.

LVERs serve veterans by helping them find employment and conducting outreach to employers. Through contact with employers, LVERs promote veterans as job-seekers with marketable skills. Outreach activities include contact with employers, advocating for veterans employment interests with business, industry, and community-based organizations; planning and participating in job fairs; and coordinating with unions, apprenticeship programs, and business organizations.

The second function includes employment and training services for veterans. Working directly with veterans, LVERs provide career guidance, identify training opportunities, and refer veterans to job interviews. As of October 2012, 89 LVERs were located in 64 TWC local workforce solution centers, although not always in the same locations where DVOPs were located. Overall, DVOPs and LVERs were placed in 77 local workforce solution centers statewide.

TVC's two Family Employment Assistance Counselors (FEACs) assist veterans and active duty military personnel and their families by providing the same employment services offered to veterans in local workforce solution centers. In particular, they focus on helping spouses of active duty service members find employment. FEACs are located in San Antonio and Killeen to assist spouses that are using services provided at Brooke Army Medical Center and Fort Hood, respectively.

TVC's Veteran Business Representatives (VBR) program expands the agency's employer outreach activities by educating businesses on the benefits of hiring veterans. VBRs also act on behalf of employers to recruit qualified veterans for new employment opportunities; and work with local development boards, the TWC, and the Department of Labor-Veterans Employment and Training Service. As of October 2012, they were located in Houston, Denton (serving the Dallas-Fort Worth area), San Antonio, and Austin.

TVC FUNDING AND PERFORMANCE

Figure 3 shows expenditure and performance information for the VES program from fiscal years 2008 to 2012. Funding for about 99.0 percent of the program is through a federal grant from the U.S. Department of Labor, Veterans Employment and Training Service. The remainder, approximately $108,000 in General Revenue Funds in fiscal year 2012, is for the Family Employment Assistance Counselors program. VES expenditures increased from $8.9 to $9.3 million during this period, and then decreased to $8.8 in fiscal year 2012 as the federal grant fluctuated. This is attributable to the DOL-VET grant formula, which allocates state grants based on a state's number of job-seeking veterans as a percentage of the national number of job-seeking

FIGURE 3
TEXAS VETERANS COMMISSION, VETERANS EMPLOYMENT SERVICES EXPENDITURES AND PERFORMANCE
FISCAL YEARS 2008 TO 2012

MEASURE	2008	2009	2010	2011	2012
Expenditures (in millions)	$8.9	$9.2	$9.3	$9.0	$8.8
Total Veterans Served	103,652	92,397	76,822	86,751	82,010
Veterans Entered Employment Rate	68.0%	68.9%	69.7%	55.0%	55.0%

Notes: Fiscal year 2012 is estimated; Entered Employment Rate reflects data from prior year.
Sources: Legislative Budget Board; Texas Veterans Commission.

veterans. As Texas' proportion of the country's veterans looking for work fluctuates, so will the DOL-VETS grant.

The number of veterans served by the VES program also fluctuated from fiscal years 2008 to 2012. Beginning in 2010, DOL-VETS requires all state veteran employment services to focus more of their time on veterans with disabilities or other barriers such as homelessness. Because this cohort is a subset of the total number of veterans visiting workforce centers, and because these veterans are more time-consuming to serve, the number of total veterans served decreased in fiscal year 2010. In fiscal year 2011, the number served increased because LVERs and DVOPs were required by TVC management to more regularly contact veterans who registered in the state's employment service online system, Work in Texas (WIT). By contacting any new veterans registering in WIT and encouraging them to visit TVC field staff, the agency saw more veterans visiting workforce centers than in prior years.

The entered employment rate performance measure represents the percentage of veterans who found employment within the quarter that they stopped receiving TVC staff services. Data for this measure comes from TWC data for the prior year. As a result, a one-year lag exists between the fiscal year and the actual year when veterans became employed. The measure therefore reflects a pattern similar to the number of veterans served—performance decreased as TVC focused its efforts on disabled and other veterans with barriers to employment for fiscal year 2011. The agency expects the entered employment rate to remain the same for fiscal year 2012.

TEXAS WORKFORCE COMMISSION

The Texas Workforce Commission (TWC) coordinates and supports three points of access for a person seeking assistance to find work. They are: the local workforce development boards, the Work in Texas (WIT) online system, and the Texas Veterans Leadership Program. Each provides employment services to veterans. The 28 local workforce development boards operate 201 workforce solution centers which offer services at no cost to those seeking employment. The centers have a variety of job-search services, tools for people with disabilities, and networking opportunities. They also offer workshops and host job fairs to assist job seekers in their efforts to find employment. Under federal law, veterans and their spouses receive priority service before other customers at all workforce solution centers when accessing services. For example, if a job training class has a waiting list, veterans and their spouses will be placed at the top of the list.

The WIT system is a free online system managed by TWC serving employers and job seekers. For job seekers, the system offers resume creation, job opportunity lists based on employment preferences, current labor market information, career tools and training resources; and access to job notices from other sources (e.g. JobCentral). The WorkInTexas-Veterans feature helps veterans translate their military skills to jobs in the civilian world. The feature allows veterans to enter the type of work they performed in the armed services and receive a list of civilian jobs that require those skills. The system has a link to the federal O*NET system that identifies careers corresponding to military occupation codes. The system places a veterans-only two-day hold on all job listings, which allows veterans to view and pursue employment opportunities before the general public sees the posting.

TWC's Texas Veterans Leadership Program (TVLP) uses Veterans Resource and Referral Specialists (VRRSs) to find ancillary services in local communities, veterans' service organizations and faith-based programs. The VRRSs seek out post-9/11 veterans and provide them with information and referral services, including referrals to TVC employment representatives. VRRSs are assigned to each of the 28 local workforce development board areas and are located in workforce solution centers in order to coordinate with center and TVC staff.

DEPARTMENT OF ASSISTIVE AND REHABILITATIVE SERVICES

The Department of Assistive and Rehabilitative Services (DARS) provides services that help Texans with disabilities, including veterans, find employment through vocational rehabilitation. DARS has a Memorandum of Agreement with the VA, Veterans Rehabilitation and Employment (VR&E) program to expand employment and rehabilitation services to veterans with disabilities in geographic areas beyond the reach of the VR&E program. DARS counselors work with VR&E staff to address veterans' employment needs statewide.

TEXAS NON-PROFIT VETERANS EMPLOYMENT PROGRAMS

Several Texas non-profit organizations offer employment programs and information services for veterans. Some examples include the American GI Forum, National Veterans Outreach Program, and the Military Warriors Support Foundation's CEO's 4 Heroes program. Also, the Partners

Across Texas, TexVet website provides information about veterans' employment services and career fairs throughout the state. Veterans can also find employment opportunities through career fairs and expos offered through cities, non-profits, and private firms. Finally, grants from the TVC's Fund for Veterans Assistance have supported employment programs offered by non-profit organizations such as Community Learning Center (CLC, Inc.) in Fort Worth.

ENTREPRENEURSHIP AND BUSINESS OWNERSHIP

Veterans show a high level of interest in business ownership. A 2011 Small Business Administration (SBA) report found that veterans are at least 45 percent more likely to be self-employed that non-veterans. Veteran business ownership is also significant in Texas—the state ranked second only to California in a 2012 report, with 199,476 veteran-owned businesses. Veteran-owned businesses accounted for approximately 9 percent of all firms in the U.S. in 2007.

A wide array of business ownership resources are available for veterans. The SBA provides veteran-specific business development information and loans. These include the Patriot Express Pilot Loan Initiative, which offers the agency's lowest interest rates for business loans; the Office of Veterans Business Development, which seeks to maximize the availability, applicability and usability of all SBA programs for veterans; and the Veterans Business Outreach Program (VBOP) which provides entrepreneurial development services such as business training, counseling and mentoring. The University of Texas-Pan American campus in Edinburg hosts the VBOP for Texas.

Several nationwide non-profit organizations also benefit veteran business development. SCORE administers the Veteran Fast Launch Initiative, which provides veterans and active duty military members with low cost resources for starting businesses, such as computer software, business ownership training, and mentoring from knowledgeable volunteers. Boots to Business, provided through the Whitman School of Management at Syracuse University, is an online three phase business ownership training program. The Entrepreneurship Bootcamp for Veterans with Disabilities offers training in entrepreneurship and small business management to post-9/11 veterans with service-connected disabilities. Texas A&M University hosts one of the programs.

TVC's Entrepreneur and Business Development Initiative seeks to identify funding sources, mentors, business opportunities and education programs. The initiative began in April 2012 by collecting information on entrepreneur resources and organizing workshops for veterans interested in starting a business. By October 2012, the initiative has held workshops in San Antonio, Dallas, and Arlington. The workshops allowed veterans to connect with veteran business owners, and learn how to create, manage, and grow a business. In the 2014–15 biennium, the agency wants to develop a network of business analysts and mentors that will include business owners and executives whose experience will benefit veterans involved in entrepreneurship.

EMPLOYER MOTIVATION TO HIRE VETERANS

Employers may opt to hire veterans for several reasons. Among those reasons cited by the U.S. Department of Labor are a veteran's ability to learn new skills and concepts, strong leadership skills, respect for procedures and accountability, and personal integrity. Because of the skills they bring to the workplace, and a desire to help former service members, companies have launched initiatives to employ veterans. To enhance those efforts, the federal government offers employers tax incentives to hire veterans; and also requires them to re-hire veterans under certain circumstances after returning from active duty. Similarly, federal and Texas state agencies must give preference to veterans in their hiring decisions under applicable law.

EMPLOYER HIRING INITIATIVES

Organizations have conducted combined and separate efforts to employ veterans. J.P. Morgan Chase and many other companies launched the 100,000 Jobs Mission in March 2011 with a goal of collectively hiring 100,000 transitioning service members and veterans by 2020. In March 2011, the U.S. Chamber of Commerce and the National Chamber Foundation launched Hiring Our Heroes campaign to help veterans and military spouses find employment. In addition to partnerships with public and private sector entities, the campaign is working with companies to hire 500,000 veterans by 2014. AT&T and TVC announced in April 2012 a partnership in which the company committed to hire veterans to fill more than 600 positions in Midland, Austin, Dallas-Fort Worth, Houston, Corpus Christi, Lubbock and San Antonio.

VETERAN HIRING INCENTIVES

The Texas Workforce Commission administers the federal Work Opportunity Tax Credit, which offers tax credits to employers hiring veterans. Employers who do so can receive $2,400 to $9,600 in tax credits depending on the target

group in which the veteran falls. As shown in **Figure 4**, the tax credit increases as the length of time unemployed rises, and if the veteran has a service-connected disability.

FIGURE 4
WORK OPPORTUNITY TAX CREDITS FOR HIRING VETERANS
AS OF 2012

VETERAN GROUP	MAXIMUM TAX CREDIT
Veterans with service-connected disability unemployed for at least six months	$9,600
Veterans unemployed for at least six months	$5,600
Veterans with service-connected disability	$4,800
Veterans receiving Supplemental Nutrition Assistance Program benefits	$2,400
Veterans unemployed for at least four weeks	$2,400

Source: Texas Workforce Commission.

The VA's VR&E program offers incentive programs to employers. Its On-the-Job Training program supplements the salary of disabled veterans participating in an apprenticeship program until they reach journeyman levels. The Special Employer Incentive Program reimburses the employer up to half of the veteran's salary for up to six months if they are receiving on-the-job training or work experience, and facing extraordinary obstacles in finding employment. The Non-Paid Work Experience program pays veterans a monthly subsistence allowance while they are in an unpaid public sector position.

EMPLOYER REQUIREMENTS TO HIRE VETERANS

The federal Uniformed Services Employment and Reemployment Rights Act (USERRA) protects the job rights and benefits of veterans and members of the active and reserve components of armed forces. USERRA provides that returning service members must be promptly reemployed in the same position that they would have attained had they not been absent for military service for less than five years, and with the same seniority, status and pay, as well as other rights and benefits determined by seniority. Individuals who believe their employment or reemployment rights under USERRA have been violated can try to resolve the issue informally through an Ombudsman of the federal Employer Support for the Guard and Reserve agency; or file a complaint with the U.S. Department of Labor, Veterans Employment and Training Service. The agency collects evidence and attempts to resolve the case through negotiation or mediation. If resolution is unsuccessful following an investigation, the individual may have his or her claim referred to the U.S. Department of Justice for consideration of representation in the appropriate District Court, at no cost to the claimant.

VETERANS HIRING PREFERENCES

Both the federal government and Texas state government statutes have provisions entitling veterans to preferential treatment in hiring decisions. A hiring preference is a practice that favors a specific group for employment. Federal law mandates that federal agencies give hiring preference to veterans based on when they were in active military duty, have a service-connected disability, or received a Purple Heart medal. Also, any employer doing business with the federal government whose contract or sub-contract is for $25,000 or more must take affirmative action to hire and promote specific types of veterans. Those with at least 50 employees and contracts of $50,000 or more must have a written affirmative action plan.

Texas law requires state agencies to give certain veterans preference in employment until at least 40 percent of the agency's employees are veterans. To be eligible for the preference, an individual must have been honorably discharged from military service, served during a national emergency for at least 90 days, or was discharged for an established service-connected disability, and is competent.

NEW VETERANS AND PROGRAM SUPPORT

Veterans' employment programs will take on greater importance as more active service members return from the wars in Iraq and Afghanistan. Although projections of Texas' veterans population growth associated with returning military are not available, the Texas Veterans Commission has indicated that many of these former service members will settle in Texas. State programs administered by TWC, TVC, local workforce boards, and private sector efforts to employ more veterans will seek continued support to ensure this population can find meaningful careers. Through those programs and efforts, veterans can find services to help them effectively make the transition from military to civilian life.

CONDUCT A NEEDS ASSESSMENT TO IMPROVE THE EFFICIENCY OF VETERANS GRANT ALLOCATIONS

The Fund for Veterans Assistance, a program administered by the Texas Veterans Commission, awards reimbursement grants to entities that offer direct services to veterans and their families. Grants are awarded on a competitive basis to local governments and non-profit organizations after grant applications are reviewed by agency staff and an advisory committee, and award decisions are made by the agency's governing commission. These reviews include agency staff evaluations of grant applications and advisory committee development of grant funding recommendations. The review process does not include a needs assessment, which would identify the most critical challenges facing veterans. Requiring the Texas Veterans Commission to conduct needs assessments before it solicits grant applications from entities serving veterans would make grant allocations more efficient and help the agency to better direct its resources to veterans' high priority needs.

FACTS AND FINDINGS

- From fiscal years 2010 to 2012, the Texas Veterans Commission awarded $23.8 million in state funds through grants to 74 non-profit organizations and local governments for financial assistance, counseling, housing, transportation, family support, and referral services.
- Funding for the Fund for Veterans Assistance comes from state lottery proceeds, state employees' charitable contributions, donations made online through the Texas Veterans Commission website, when motorists register vehicles, and the Housing Trust Fund. Proceeds from the Texas Lottery Commission's veterans cash ticket sales provided approximately $5 million in fiscal year 2012.
- The Eighty-second Legislature, Regular Session, 2011, transferred the Housing for Texas Heroes program from the Texas Department of Housing and Community Affairs to the Texas Veterans Commission. As a result, the agency will award approximately $3.2 million in total grants out of the Housing Trust Fund during the 2012–13 biennium for veterans' permanent and temporary housing.

CONCERN

- The Texas Veterans Commission does not conduct needs assessments before allocating grant funds. Consequently, the agency is awarding grants without sufficient information regarding the services or service level intensity that veterans need upon leaving military service.

RECOMMENDATION

- **Recommendation 1:** Amend statute to require the Texas Veterans Commission to conduct a needs assessment that will direct the allocation of grants from the Fund for Veterans Assistance. The needs assessment should be conducted at least every two years and incorporated into the grant award decision-making process.

DISCUSSION

The Fund for Veterans Assistance (FVA) was established by the Seventy-ninth Legislature, Regular Session, 2005, and authorized to receive funding from legislative appropriations, gifts and grants, and fund earnings. Legislation passed by the Eight-first Legislature, Regular Session, 2009, established an instant ticket lottery game, the veterans cash ticket, to benefit the FVA. Legislation passed during the same session authorized state employees to make charitable contributions, and motorists to make contributions when they register their vehicles, to the FVA. Also, the Housing for Texas Heroes program was transferred to the Texas Veterans Commission (TVC) from the Texas Department of Housing and Community Affairs by a rider in the 2012–13 General Appropriations Act. TVC began allocating grants under the new FVA program for permanent and temporary housing beginning in fiscal year 2012, and will disburse $3.2 million in grants during the 2012–13 biennium.

The purpose of the FVA is to award grants to help address veterans' needs. The TVC awards reimbursement grants from the FVA to non-profit organizations and local governments that offer direct services to veterans. These services include financial assistance, housing/homelessness, counseling, referral, family services, supportive services, legal, employment, and transportation. Expenditures for the FVA are estimated to be $10.9 million in fiscal year 2012, and

$8.9 million in fiscal year 2013. The decrease in fiscal year 2013 is due to one-time expenditures of $2.8 million for the Housing for Texas Heroes program in fiscal year 2012.

GRANT APPLICATIONS

Organizations eligible for FVA grants are local governments, organizations of armed forces members (past or present), nonprofit organizations, and veterans service organizations. From March 2010, when the first grant award was distributed, to July 2012, the agency awarded 95 grants to 74 organizations and local governments, 18 of whom received more than one grant. During the same period, 423 grant applications were filed with the agency for FVA funding.

To apply for a grant, an eligible entity must submit a grant application as well as documents indicating the financial stability, adequate insurance, and tax and state business status of the organization. Since the FVA began in 2009, TVC has modified the application so that it is consistent with its evaluation rubric.

The application contains six sections, including:

- organizational information which describes the organization and its structure; identifies community partners, prior grants received in the last two years and the type of grants received;
- grant project information that identifies the primary service provided based on agency determined categories; summarizes the proposed project; who will be eligible for services;
- reporting and management information that indicates how project performance will be tracked, targets for number of veterans, dependents and surviving spouses served; how performance data are collected; fiscal management of the project, how fiscal reporting to TVC will be conducted; and how the project will be continued after FVA funding has ceased;
- budget and budget narrative that describes the project budget and a detailed description of each budget line item;
- statement of work that provides a detailed description of the project, how the need for the applicant's services were determined and how it will address that need; how outreach to veterans will be done, how FVA funding will be cited in the grantee's public information; and
- current or prior grantee's basic information about FVA grants, the extent to which they have met performance and expenditure benchmarks set by TVC, and challenges/successes experienced during that grant period.

GRANT AWARD PROCESS

The agency allocates FVA funding through a grant cycle process. Two grant cycles are initiated each fiscal year, in January and July, and last approximately 18 months. The cycle begins with a four-stage grant award process. In the first stage, the agency solicits and receives grant applications from eligible entities. In the second stage, agency staff evaluates all applications, and then forwards their evaluations and grants applications to an advisory committee. Next, the advisory reviews staff evaluations and applications, and meets to make grant award and funding recommendations. Finally, the five-member Texas Veterans Commission reviews the advisory committee recommendations, and then meets to make final grant award decisions, Afterwards, agency staff develop grant contracts in preparation for disbursements to grantees. Actual grant distributions continue for 12 months, except in those cases in which TVC approves an extension.

The staff grant review step involves an evaluation of applications using a standard rubric and rating process. The evaluation method, or rubric, entails staff assigning a rating of outstanding, satisfactory, or unsatisfactory to each section of the application's six sections mentioned previously. It uses criteria including the applicant's connection with veteran service organizations, appropriate financial controls, ability to sustain the funded program after the grant, a determination of service need, and whether it met performance benchmarks as a former grantee. Certain application sections, such as the budget and statement of work, are given more weight than secondary ones such as organizational information, in developing an overall rating for the application. Staff then assigns an overall rating ranging from outstanding to unsatisfactory to each application, and ranks them by their ratings-based quality.

In the next stage, an advisory committee composed of nine members with a range of relevant expertise, reviews grant applications and staff evaluations, ratings, and application rankings. The committee then meets to develop grant award recommendations. The committee's work also involves: considering the availability of funding as well as TVC's priorities of funding outstanding grant applications; ensuring a reasonable distribution of grants across geographic regions;

targeting awards to the three key service categories of financial assistance; counseling and housing/homelessness; and avoiding an over-saturation of grant funding in each of the TVC-designated FVA regions and service categories. The committee produces a list of grant application awards and funding recommendations for each service category and region.

The agency's five-member commission, in the final stage, makes final grant award decisions based on the advisory committee recommendations. Actions it takes include adopting advisory committee grant recommendations, adjusting recommended grant application funding amounts, or not approving a recommended grant application. After their decisions are made, TVC staff begins the process of finalizing grant contracts with approved applicants.

This process, however, results in grants being awarded without the benefit of independent information that would provide the agency with information about specific high priority needs for services within geographic regions. The lack of this information prevents TVC from targeting its resources to efficiently address high priority needs, which could include mental or physical health challenges. Although TVC requires grant applicants to identify the need for their specific services, applicants do not have to provide data indicating the extent of unmet need. Consequently, grant applications provide TVC an incomplete understanding of the demand for services, such as counseling, in each FVA region of the state.

NEEDS ASSESSMENTS TO IMPROVE THE GRANT AWARD PROCESS

According to organizational experts, a needs assessment is "a systematic set of procedures conducted for the purpose of setting priorities and making decisions about program or organizational improvement and allocation of resources. The priorities are based on identified needs." In this context, a need is the gap between the existing conditions of a group, and the preferred conditions for the group. A needs assessment identifies these gaps and sets priorities to address them.

RMC Research Corporation, a program evaluation firm, identified these characteristics of a valid needs assessment:

- uses information collected from a variety of sources;
- creates the foundation for goals and action plans;
- is used for resource allocation decisions; and
- leads to regular updates of plans and strategies.

Organizational experts have noted several benefits of a needs assessment. First, it provides a useful approach to identifying and describing specific areas of need, understanding factors that contribute to them, and determining the basis for plans to address them. A valid assessment lays the groundwork for designing improved services and helps identify solutions to complex problems. Assessments should determine the needs of the people for whom the organization or program serves, and have as its main beneficiaries the service population rather than the organization itself.

A common approach to conducting a needs assessment is to plan the assessment project, collect and then analyze data, develop findings and recommendations, and present the results of the assessment project. Collection methods include surveys, focus group interviews involving the service population, and communication with stakeholders. According to best practice research, a valid assessment uses information from more than one source. A mix of data collection methods can help validate the findings.

Needs assessments in two states have helped inform the provision of services to veterans. Virginia's Wounded Warrior program, an inter-agency regional coordination network, commissioned a needs assessment from Virginia Polytechnic Institute and State University (Virginia Tech), to inform program design, allocation decisions, and policy development. Virginia Tech conducted a telephone survey and focus group interviews with veterans and service providers working with veterans; and an analysis of the location of veteran services compared to veterans residential patterns. The assessment, according to a report issued in 2010, found that the high priority needs of veterans are better information regarding how to access services, reducing barriers to quality healthcare services, additional/better services for their families, and employment/economic assistance. The report recommended increasing service provider coordination and partnership building, raising cultural competence among service providers, and improving the information network for veterans, families and service providers.

Rand Corporation conducted a needs assessment of veterans in New York for the New York State Health Foundation, and issued a related report in 2011. The purpose of the assessment was to provide information to guide the foundation's research, and assist veterans and their stakeholder groups. The assessment included telephone and online surveys of veterans, focus group interviews, and meetings with

veteran-related state agencies. Some of the assessment's findings were that veterans have a range of mental health concerns, difficulties reconnecting with friends and family, and problems finding jobs commensurate with their skills. Also, veterans indicated it is extremely difficult to navigate the existing system of benefits and services across all providers. The veterans' suggestions included: improving military out-processing and subsequent outreach and educational efforts to increase utilization of existing services; expanding veteran services to reduce travel time, wait times, and delays in scheduling appointments; and expanding programs to help families of veterans.

Both of these assessments produced findings and recommendations that identified high priority needs of veterans and ways to address them. An assessment of Texas veterans' needs could similarly highlight their critical concerns and gaps in services. To implement this approach, Recommendation 1 would amend the Texas Government Code, Section 434.017, to require TVC to conduct a needs assessment to direct the allocation of grants from the FVA. The assessment should be conducted at least every two years and incorporated into the grant award decision-making process. This would allow TVC to allocate FVA grants in a way that would result in services that target specific high priority needs and thereby improve outcomes. The results of the TVC needs assessment should be an identification of specific high priority needs of veterans, a determination of services that address those needs, and a prioritized allocation of funds across service categories and geographic regions. To allow the agency adequate time to complete the assessment, the first one would be completed by May 1, 2014, which would coincide with the second grant cycle process in the first fiscal year of the 2014–15 biennium.

FISCAL IMPACT OF THE RECOMMENDATION

The recommendation does not have a direct fiscal impact in the 2014–15 biennium. The TVC would be required to conduct the needs assessment with its existing appropriations. The cost of performing the assessment would depend on the extent of resources dedicated to completing it, which could be contracted to an entity experienced with conducting this type of research. As an example, the needs assessment conducted for Virginia cost approximately $160,000.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of this recommendation.

INCREASE STATE EMPLOYEE AWARENESS OF LIFE AND DISABILITY INSURANCE BENEFITS

The Texas state employee benefits package, administered by the Employees Retirement System, includes optional enrollment in insurance coverage for term life, short-term disability and long-term disability. Premiums paid by employees who elect to participate in these plans cover the full cost of these benefits. These types of coverage can increase an employee's financial security and assist an employee or his or her family through a period without the employee's income.

For optional term life insurance, employees may elect coverage equal to one to four times of their annual salary as a death benefit for their beneficiaries. Short-term disability insurance provides a maximum benefit of 66 percent of monthly salary, up to $10,000, or $6,600, whichever is less, for up to five months. Long-term disability insurance provides a maximum benefit of 60 percent of monthly salary, up to $10,000, or $6,000, whichever is less, for a period ranging from 12 months up to age 65, depending on an employee's age at the time of disability. Despite the availability of these benefits, many workers underestimate its importance or do not fully understand the benefits or limitations that come with the plans. Increasing awareness of life and disability insurance coverages, including its benefits, eligibility and limitations, may increase state employee participation and ensure covered employees better understand these benefit programs.

FACTS AND FINDINGS

- State employees have a comparable or higher participation rate in life and disability insurance programs than other employee populations. As of September 2012, 70 percent of state employees were enrolled in optional term life insurance coverage. For the same period, 52 percent of state employees were enrolled in short-term disability life insurance coverage and 41 percent in long-term disability insurance coverage.
- Life and disability insurance address risks related to premature death and disability. Men have a one-in six chance and women a one-in-ten chance of not surviving from age 35 to normal retirement age. In addition, most U.S. workers believe they have a 2 percent or less risk of becoming disabled; the actual probability of becoming disabled for three months or longer is closer to 30 percent.
- Many U.S. workers do not have sufficient savings to cover six months of living expenses. Twenty-eight percent do not have any emergency savings to replace lost income.
- The state provides a basic life insurance benefit of $5,000 for employees and $2,500 for retirees at no cost to the member for those enrolled in the Group Benefits Plan. While this benefit level would cover small expenses, it is unlikely to sustain an employee's family or dependents for a more than a few months.
- From fiscal years 2009 to 2011, a number of state employees and retirees who purchased optional term life or disability insurance were denied benefits they anticipated receiving due to pre-existing conditions or other exclusions.

CONCERNS

- Employees may underestimate their risk of premature death or disability, which can affect their decision to enroll in life and disability insurance plans. Since employees choose from four levels of life insurance coverage and two types of disability insurance, it may be difficult for them to evaluate and compare policies.
- Although the Employees Retirement System and its insurance vendors disclose all exclusions and limitations for life and disability insurance coverages in publications, this information is not readily available or easily understandable.

RECOMMENDATION

- **Recommendation 1:** Include a rider in the introduced 2014–15 General Appropriations Bill to encourage the Employees Retirement System to provide more information about optional life and disability insurance, including overlap with other disability income sources and more easily accessed disclosure of limitations and exclusions.

DISCUSSION

Many workers often underestimate their risk of disability or premature death, and therefore the risk to themselves and their family if their income is no longer available to cover bills. In addition, according to a Bankrate survey, 49 percent of U.S. workers do not have enough emergency savings to cover six months worth of living expenses, the amount recommended by financial planners, and 28 percent have do not have any emergency savings. The state employee compensation package includes a mixture of mandatory and optional benefits that can enhance an employee's financial security. To address the risks related to disability or premature death and lost income, the state offers optional term life insurance and disability insurance coverage, administered by the Employees Retirement System (ERS).

TERM LIFE INSURANCE

According to Milliman, in the United States men have a one-in six chance and women a one-in-ten chance of not surviving from age 35 to normal retirement age. Premature death is the death of an income earner with outstanding unfulfilled financial obligations, which can incur costs for the worker's family. These costs can include the loss of the worker's future earnings; additional death-related expenses such as a funeral or uninsured medical bills; and a reduction in the family's standard of living due to the income loss. Life insurance is typically recommended to income earners that have others depending on them for any amount of financial support.

Public and private sector employers may offer a basic life insurance plan, a plan with larger amounts of coverage, or both. To meet the life insurance needs of state employees, ERS offers two plans, an automatic basic plan and an optional plan. The state provides a basic life insurance benefit of $5,000 for employees and $2,500 for retirees at no cost to the member for those enrolled in the Group Benefits Plan. While this benefit level would cover small expenses, it is unlikely to sustain an employee's family or dependents for a more than a few months.

To meet extended life insurance needs, ERS offers optional group term life insurance to active state employees that is provided by Minnesota Life. This plan is fully funded by employee and retiree contributions. Term life insurance provides temporary protection at a lower cost than other types of life insurance and is limited to a specific period or term. Current employees may elect coverage equal to one to four times their annual salary as a death benefit for their beneficiaries. Retirees who are enrolled at the time of retirement may keep their coverage at one or two times annual salary. According to Minnesota Life, examples of how the life insurance benefit can be used by dependents include as a supplemental income; to pay down or pay off a mortgage, medical bills or other large debts; establish college funds for any dependent children; help pay for funeral or probate expenses; and leave a charitable legacy.

Figure 1 shows life insurance participation rates among current state employees, private sector employees, and public sector employees.

FIGURE 1
LIFE INSURANCE PARTICIPATION RATES BY EMPLOYEE POPULATION, 2012

EMPLOYEE POPULATION	PARTICIPATION RATE (PERCENTAGE)
STATE OF TEXAS EMPLOYEES	
Basic Life	96%
Optional Term Life	70%
OTHER EMPLOYEE POPULATIONS	
Private sector	56%
State and Local Government	77%

SOURCES: Employees Retirement System; U.S. Bureau of Labor Statistics.

As shown in **Figure 1**, as of September 2012, 207,612 employees, or 96 percent those eligible, were covered by the basic life insurance plan ERS offers. For the same period, 150,802 employees, or 70 percent of those eligible, were enrolled in the optional term life insurance that offers additional coverage. These participation rates are comparable or higher than private and public sector employees.

According to ERS, the basic and optional insurance plans receive claims each year. From the optional group term life insurance plan, in fiscal year 2011, 1,469 beneficiaries received life insurance claim payments. **Figure 2** shows the detail on benefits paid for fiscal year 2011.

FIGURE 2
OPTIONAL GROUP TERM LIFE INSURANCE BENEFITS PAID FISCAL YEAR 2011

BENEFITS	ACTIVE EMPLOYEES	RETIREES
Total Benefits Paid	$30.2 million	$23.0 million
Number of Beneficiaries	667	802
Average Payment	$45,273	$28,736

SOURCE: Employees Retirement System.

As shown in **Figure 2**, the average benefit paid for the optional group term life insurance is higher than the basic plan benefit, which would allow dependents to cover more expenses or maintain their current standard of living for a longer period.

DISABILITY INSURANCE

Disability insurance benefits replace income when an insured individual is unable to work due to injury or illness. ERS offers optional short- and long-term disability insurance to state employees, which is funded by employee contributions. Not all disability periods are long-term or permanent, but any period without income due to a disability can be disruptive to a worker's financial security.

State employees have a high participation rate in disability insurance programs in comparison other employee populations. **Figure 3** shows disability insurance participation rates among current State of Texas employees, private sector employees, and public sector employees

FIGURE 3
DISABILITY INSURANCE PARTICIPATION RATES BY EMPLOYEE POPULATION, 2012

EMPLOYEE POPULATION	SHORT-TERM DISABILITY PARTICIPATION RATE (PERCENTAGE)	LONG-TERM DISABILITY PARTICIPATION RATE (PERCENTAGE)
State of Texas	52%	41%
Private sector	38%	32%
State and Local Government	22%	34%

SOURCES: Employees Retirement System; U.S. Bureau of Labor Statistics.

As shown in **Figure 3**, as of September 2012, 52 percent of employees were enrolled in the short-term disability plan and 41 percent were enrolled in the long-term disability plan. These participation rates are higher than private sector and government employees. However, 104,086 employees, almost half of those eligible, were not enrolled in the short-term disability plan. For long-term disability insurance, 128,308 employees who were eligible were not enrolled. Despite the high participation rate, the financial security risk posed by the inability to work due to a disability can lead to bankruptcy, foreclosure, and other credit issues for employees.

The risk of becoming disabled is underestimated by most U.S. workers. According to the Council for Disability Awareness, a majority of U.S. workers believe they have a 2 percent or less risk of becoming disabled for three or months or longer, while the actual probability of becoming disabled during a worker's career is closer to 30 percent. In addition, less than 5 percent of disabling events are work related, so Workers' Compensation would not cover most disabling events. Providing information about employee risk related to disability can assist state employees in making informed decisions regarding enrollment in this benefit.

Disability insurance policies typically cover 60 percent to 80 percent of gross earnings. Group disability insurance plans are usually offered as separate short- and long-term plans. For state employees, disability insurance is offered through Dearborn National. The short-term disability insurance plan provides a maximum benefit of 66 percent of monthly salary (up to $10,000) or $6,600, whichever is less, for a period no longer than five months. The long-term disability insurance plan provides a maximum benefit of 60 percent of monthly salary (up to $10,000) or $6,000, whichever is less, for a period ranging from 12 months up to age 65, depending on an employee's age at the time of disability. According to the Council on Disability Awareness, the average long-term disability absence lasts 32.1 months. To provide adequate income protection, employees may benefit from enrolling in both types of coverage.

In fiscal year 2011, 6,192 beneficiaries received disability insurance claim payments. **Figure 4** shows the detail on benefits paid for fiscal year 2011.

FIGURE 4
DISABILITY INSURANCE BENEFITS PAID FISCAL YEAR 2011

BENEFITS	SHORT-TERM DISABILITY	LONG-TERM DISABILITY
Total Benefits Paid	$10.3 million	$22.9 million
Number of Beneficiaries	2,950	3,242
Average Annual Payment	$3,503	$7,070

SOURCE: Employees Retirement System.

POLICY LIMITATIONS AND BENEFITS DENIALS

The optional group term life and disability programs offered through ERS have coverage limitations and exclusions. These limitations may not be readily understood by an individual who is considering enrolling in these plans.

The optional group term life insurance plan includes several limitations and exclusions for coverage. The optional group term life insurance plan includes an accidental death and dismemberment (AD&D) feature where the benefit is equal

to the coverage of one to four times annual salary selected by the plan member. Under the AD&D feature, benefit payments can be denied if an accident occurs while the insured is serving in the military, intoxicated, or while engaged in felonious activity. In addition, the plan will not pay benefits if the employee's death is the result of intentionally self-inflicted injuries or suicide unless the insurance coverage has been in force for two years or longer prior to death. Claims can also be denied for general ineligibility, such as not meeting filing deadlines.

From fiscal years 2009 to 2011, an average of 71 state employees and retirees were denied a benefit payment for optional term life insurance per year. An average of five employees per year were denied due to a suicide exclusion and an average of 17 denials per year due to drug or alcohol intoxication.

The short- and long-term disability insurance plans also include several limitations and exclusions for coverage. Disability claims can be denied if an insured member does not meet the definition of total disability or meet the required waiting periods, which is 30 days for short term and 180 days for long term. Disability claims can also be denied for pre-existing conditions within three months of the time coverage begins. Other examples of exclusions include disability related to:

- self-inflicted injuries;
- an accident that occurs while the insured is serving in the military;
- the insured being intoxicated; or
- being an organ donor.

From fiscal years 2009 to 2011, an average of 431 state employees were denied a benefit payment for optional short-term disability life insurance per year. Of these, an average of 61 employees per year were denied due to a pre-existing limitation and an average of 107 per year due to not meeting the waiting period. For the same period, an average of 954 state employees were denied a benefit payment for optional long-term disability life insurance per year. Of these, an average of 33 per year were denied due to a pre-existing limitation and an average of 691 per year due to not meeting the waiting period.

In addition to the limitations discussed previously for short- and long-term disability plans, another limitation is a reduction in the benefit provided by Dearborn National due to integration with other sources of disability income. Short- and long-term disability benefits are integrated with any benefit received by the insured from workers' compensation, Social Security Disability Income, ERS or Teacher Retirement System (TRS) retirement disability benefits, and other group disability benefits. If integration with other disability income sources applies to an insured, the member's combined benefits from all sources will replace up to 70 percent of salary for short- and long-term disability. From fiscal years 2009 to 2011, per year, an average of 30 employees were denied short-term disability and an average of 8 were denied long-term disability benefits due to integration.

EMPLOYEE INFORMATION ON LIFE AND DISABILITY INSURANCE BENEFITS

ERS offers informational opportunities to employees and retirees on the benefit programs it administers. During fiscal year 2012, the agency hosted 223 informational events with approximately 26,000 attendees. Life and disability insurance were discussed at all of these events. Annual enrollment brochures and employee and retiree benefit guides include information on these plans.

While participation rates in these optional plans is high compared to all private and public sector employees, there is significant financial risk to employees and their dependents when they lack sufficient savings or insurance coverage to cover income lost related to premature death or disability. In addition, most of the information about exclusions and limitations for these plans requires an employee to retrieve documents after connecting through multiple website links for ERS and the plan vendors Minnesota Life and Dearborn National. The documents that include information on limitations are lengthy. Highlighting these limitations in shorter documents or presentations may aid in employee understanding of the plans.

To potentially increase employee participation and understanding of life and disability insurance plans, including the coverage limitations, Recommendation 1 would include a rider in the introduced 2014–15 General Appropriations Bill to encourage ERS to provide more informational opportunities to employees about these plans, including overlap with other disability income sources and more easily accessed disclosure of limitations and exclusions.

FISCAL IMPACT OF THE RECOMMENDATION

The recommendation would not have a fiscal impact to the state. Optional programs such as term life and disability insurance are funded through employee contributions and do not receive state appropriations.

The introduced 2014–15 General Appropriations Bill includes a rider to implement Recommendation 1.

MODIFY THE HIGH-COST GAS TAX-RATE REDUCTION TO INCREASE ITS COST TRANSPARENCY AND EFFECTIVENESS

The oil and gas industry generates both jobs and wealth in Texas. The last several decades have seen continued growth in this industry, first through the development and production of resources from the Barnett Shale, a gas rich geological formation lying beneath several counties in north Texas, and more recently in the Eagle Ford Shale in south Texas. The continuing economic development potential of natural gas production led Texas to develop a severance tax policy that provides financial benefits to natural gas producers, specifically those who choose to undertake non-traditional forms of gas production.

Natural gas production in the state is taxed at 7.5 percent of market value; however, deductions, exemptions, and rate reductions have reduced many producers' tax liabilities to zero and reduced the overall effective rate in recent years. In fiscal year 2011, 7.7 billion thousand cubic feet (Mcf) of natural gas was produced in Texas, resulting in tax collections of $1.1 billion or 2.9 percent of total state tax collections. This was an increase from a low of $725.5 million in fiscal year 2010. This amount is a fraction of the total amount that would be collected at the full tax rate. The high-cost gas tax-rate reduction reduced tax-payer liabilities for the natural gas production tax by $984 million in fiscal year 2011.

FACTS AND FINDINGS

- High-cost gas tax-rate reductions are based on production definitions established in the late 1970s, which allow drilling operations to be certified as "high-cost" regardless of the actual production cost. These definitions rely on the type of gas produced and manner of production. In fiscal year 2009, this resulted in the certification of a $24,000 gas well as a high-cost operation when the median drilling cost was $2.3 million.
- The high-cost gas-rate reduction changes the natural gas production market by giving preferential tax treatment to one form of production versus another, regardless of the actual cost of extraction. In fiscal year 2011, high-cost gas wells represented 55 percent of total gas production in the state.
- The cost to the state of high-cost gas tax-rate reductions reached a high of $1.97 billion in fiscal year 2008, and averaged $1.17 billion during fiscal years 2004 to 2011. Since fiscal year 2004, the value of high-cost gas tax-rate reductions has totaled $9.4 billion in forgone state revenue.
- Drilling and completion costs for the 2,355 high-cost gas wells approved for high-cost gas tax-rate reductions during fiscal year 2011 totaled $10.9 billion, resulting in the potential for state revenue losses of $5.4 billion through 2021 from the wells drilled in 2011.

CONCERNS

- Relatively inexpensive recompletions are defined by statute and classified by the Railroad Commission of Texas as high-cost wells. These wells reduce the median drilling and completion costs used to calculate the tax benefit. Using median drilling and completion costs rather than mean drilling and completion costs resulted in larger rate reductions for 93 percent of the wells in the sample of fiscal year 2009 completions provided by the Comptroller of Public Accounts.
- The Comptroller of Public Accounts is required by statute to report on the effect of exemptions, discounts, and exclusions of sales, excise, and use; franchise; school district property taxes; motor vehicle; and any other tax generating in excess of 5 percent of state collections in the prior fiscal year. The *Tax Exemptions and Tax Incidence* report does not include information on taxes that would otherwise meet the minimum threshold for inclusion in the report if the value of the exemptions were considered. This results in a lack of public information regarding some state programs, including the high-cost gas-rate reduction.
- The future revenue generating capability of the natural gas production tax is in doubt. Production trends are toward methods that are currently defined as high-cost and subject to reduced tax rates. No analysis has been done to determine the market price at which the high-cost gas-rate reduction is an incentive for producers to drill new wells.

RECOMMENDATIONS

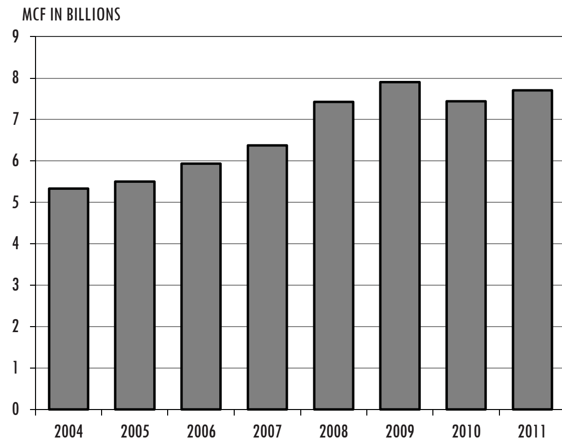
- **Recommendation 1:** Amend statute to use mean drilling and completion costs instead of median drilling and completion costs in the calculation of the high-cost gas tax benefit.
- **Recommendation 2:** Amend statute to require the Comptroller of Public Accounts to include the estimated value of exemptions, discounts, and exclusions, when identifying taxes for inclusion in the biennial *Tax Exemptions and Tax Incidence* report.
- **Recommendation 3:** Include a rider in the introduced 2014–15 General Appropriations Bill to require the Comptroller of Public Accounts to conduct a study to determine at what natural gas prices, if any, the high-cost gas-rate reduction incentivizes production. The Texas Legislature could amend statute in the next legislative session to make the rate reduction effective only at natural gas prices at which the Comptroller of Public Accounts has determined that the rate reduction incentivizes production. This program would be administered in a similar manner to the low producing well exemption.

DISCUSSION

The oil and gas industry is a significant contributor to the Texas economy and state revenue. While traditional gas production positioned Texas as a leader in world energy markets, continuous experimentation with new methods of natural gas production has contributed to industrial development within the state. During the last decade, increased development of the Barnett Shale in north Texas has helped the state's gas industry grow. The relatively recent development of the Eagle Ford Shale in south-central Texas has also provided an economic boost and grown the state's oil and gas industry. As shown in **Figure 1**, data from the Comptroller of Public Accounts (CPA) shows that from fiscal years 2004 to 2011 natural gas production in the state rose from 5.3 billion Mcf to 7.7 billion Mcf, with a peak of 7.9 billion Mcf in 2009. (Mcf is a thousand cubic feet.) This level of production was made possible in large part by a 41 percent increase in the number of active wells during that time, reaching 101,831 in 2011. During this period, average production per well actually decreased by 14 percent to 69,248 Mcf per year.

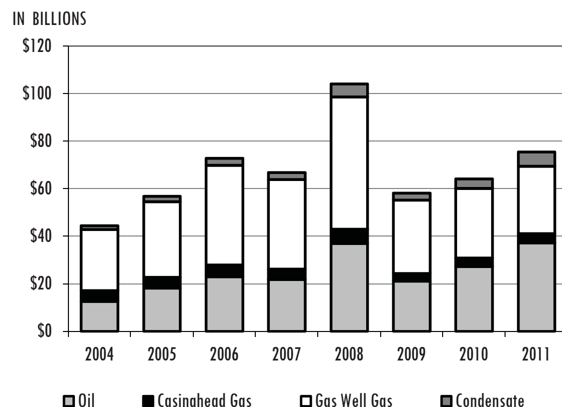
From fiscal years 2004 to 2011, Texas producers were responsible for 29.6 percent of all domestic natural gas production and 21.6 percent of all crude oil production. In 2011, the industry extracted an estimated $75.5 billion in oil and natural gas, which is a 70.1 percent increase from 2004 production. This increase was driven largely by modest increases in oil production and a dramatic increase in the price of oil. According to an analysis of Railroad Commission of Texas (RRC) and U.S. Energy Information Administration data, the value of Texas production peaked in 2008 at $104.2 billion. **Figure 2** shows the estimated value of oil and gas production in Texas from fiscal years 2004 to 2011.

FIGURE 1
NATURAL GAS PRODUCTION IN TEXAS
FISCAL YEARS 2004 TO 2011



SOURCE: Comptroller of Public Accounts.

FIGURE 2
ESTIMATED VALUE OF OIL AND NATURAL GAS WELL PRODUCTION, FISCAL YEARS 2004 TO 2011



SOURCES: Railroad Commission of Texas; U.S. Energy Information Administration.

In the last two decades, the energy industry has sought opportunities to develop non-traditional domestic sources of energy, including oil-sand, coal-beds, and shale deposits. Traditional natural gas wells seek out gas stored in geological reservoirs where it has become trapped. Shale production bypasses storage areas and instead drills straight into the source, the natural rock from which the gas will eventually be released. One shale drilling process, fracturing, releases gas stored in solid rock by pumping a mixture of sand and water through a well to cause fractures, releasing pent-up gas. Fracturing processes have achieved such success that shale gas production has grown from 1 percent of natural gas production in the U.S. to almost 10 percent during the last decade. Shale gas wells can be drilled in the conventional vertical model, or in a horizontal model that seeks to maximize initial production. Horizontal wells carry an average increased cost of 2.5 times a standard vertical well. Horizontal wells are more productive on average than vertical wells; however, that advantage has been shrinking. In the sample of wells provided by CPA drilled in 1996, horizontal wells were 143 percent more productive than vertical wells. By 2006, however, horizontal wells were only 63 percent more productive than vertical wells.

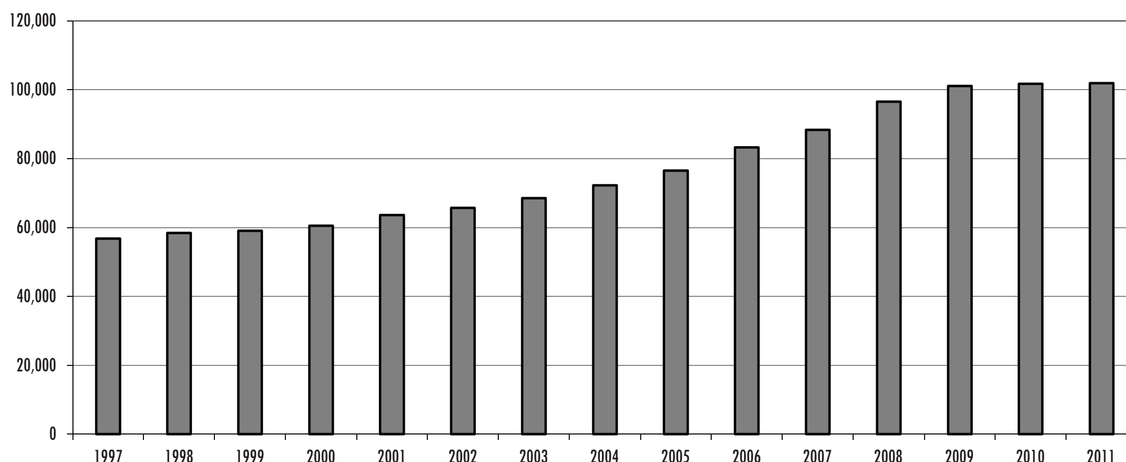
Several other large shale fields are now being developed throughout the U.S. and Canada; the largest of the new fields is the Marcellus Shale, lying under Pennsylvania, West Virginia, and New York. The Marcellus Shale is larger than Barnett, by 90,000 square miles, and is estimated to have 10 times the gas production potential as Barnett. Pennsylvania recently enacted a price sensitive Marcellus Shale impact fee that imposes a fee on unconventional wells in each of the first 15 years of production. At current prices, the fee is $50,000 for each horizontal well and $10,000 for each vertical well in the first year of production and the fee decreases each year. In fiscal year 2012, the fee generated $204.2 million in revenue to be split between the state and local governments.

Geologists believe the Marcellus formation could contain sufficient gas deposits to power the U.S. for the next two decades. Because of these predictions, and other factors related to gas production processes such as lease timing and proximity of the gas to end consumers, many of the largest natural gas producers have begun to focus their attention to the east, although it is still unclear what impact the shift has had, or will have, on gas production in Texas. Such conditions, if persistent, could lead to slower rates of new well development in Texas. **Figure 3** shows the number of natural gas wells operating in Texas from fiscal years 1997 to 2011.

TEXAS SEVERANCE TAXES

Oil and natural gas production in Texas is taxed as part of the state's severance tax structure, which taxes the removal of natural resources from Texas land. Severance taxes are defined as taxes on extracting, or severing, natural resources such as oil, gas, sulphur, or coal, from the earth. Natural gas production taxes are statutorily set at 7.5 percent of the market value of gas produced within the state borders, while oil and condensate are taxed at 4.6 percent of market value. For many drilling operations, the tax rate on natural gas

FIGURE 3
NUMBER OF NATURAL GAS WELLS OPERATING IN TEXAS, 1997 TO 2011

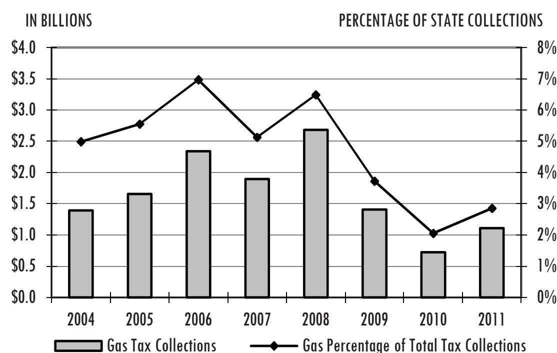


SOURCE: Railroad Commission of Texas.

production is reduced to 0 percent during the first 120 months of production or until the site recovers 50 percent of its drilling and completion costs due to the high-cost gas-rate reduction. For taxation purposes, the market value of natural gas is determined by its value at the site of the producing well, a price that can be highly volatile due to both national and international economic factors. The average wellhead price of gas declined from a high of $10.79 per Mcf in July 2008 to a low of $1.89 per Mcf in April 2012, before rebounding slightly to $2.59 in July 2012. The amount of gas that will be subject to the tax is determined by meters placed at the well site with data collected before the resource leaves the lease property boundary, either by entering a pipeline or through delivery to a processing plant. The data is then reported to the state by the operator.

Severance tax on gas production has proven to be an important revenue source for the state. In 2011, natural gas tax collections were $1.1 billion, making up 2.9 percent of total state tax collections. This is an increase of 53 percent from $725.5 million in 2010. During the last four biennia, the state has collected $13.2 billion in natural gas production taxes, an average of $1.65 billion per year. Because natural gas production taxes are classified as occupations taxes, 25 percent of total collections are deposited for the benefit of public schools. **Figure 4** shows the natural gas tax collection totals and the related percentage of total state tax collections for fiscal years 2004 to 2011. When oil production and regulation taxes are included, 6.6 percent of state tax collections came from the state severance taxes in 2011. Sales tax revenue related to oil and gas extraction generated the state an additional $489.1 million or 2.3 percent of all sales tax revenue in 2011.

FIGURE 4
NATURAL GAS PRODUCTION TAX COLLECTIONS
FISCAL YEARS 2004 TO 2011



Source: Comptroller of Public Accounts.

ECONOMIC STABILIZATION FUND

The growth of the state's Economic Stabilization Fund (ESF)—also referred to as the "Rainy Day Fund"—bears a direct relationship to natural gas tax collections. Constitutionally, an amount of General Revenue Funds equal to 75 percent of natural gas tax collections in excess of 1987 revenue, $599.8 million, is deposited to the ESF after the end of each fiscal year. Historically, natural gas tax-revenue-related deposits are the largest component of the ESF, representing 65.5 percent of deposits from 1990 to 2012. The largest gas tax-related deposit to the ESF, $1.6 billion, occurred in September 2008, based on tax collections received for fiscal year 2008. Gas tax-related deposits to the ESF dropped to $382 million in September 2011.

LOCAL GOVERNMENT REVENUE

In addition to providing revenue to the state, the oil and gas industry also contributes to local government revenue. The primary direct impact is by increasing the property tax base through increases to the mineral related property value. Mineral-related property accounts for approximately 5 percent of total property value in Texas. From fiscal years 2004 to 2011, mineral-related property value grew significantly, increasing from $51.6 billion to $106.7 billion. This rate of growth far outstrips the rate of growth for non-mineral-related property of 53 percent during the same period. The growth of mineral-related property value was most striking in the counties located over the Barnett Shale, which increased by 316.8 percent. The Barnett Shale counties accounted for 20.5 percent of the total growth in mineral related property value in the state. This increase in property value provides a funding source from which local governments can generate revenue to help offset costs for infrastructure demands placed on them by the oil and gas extraction-related development.

PUBLIC EDUCATION FINANCES

One impact of this newfound property wealth for school districts located in shale production areas is that, in addition to having the ability to generate more revenue at similar tax rates, some school districts that had been historically property poor are now sufficiently property wealthy to have their added revenue subject to recapture. Recapture is the mechanism through which the state seeks to equalize revenue between property wealthy and property poor school districts such that school districts have access to similar revenue at similar tax rates regardless of property wealth. From 2000 to 2004, the recapture from the school districts of the core

counties of the Barnett Shale increased from $11.1 million to $70.2 million and was $73 million in 2011. From fiscal years 2004 to 2011, the school districts over the Eagle Ford Shale experienced similar growth in recapture to what the Barnett Shale area school districts experienced in the early part of the decade, increasing from $15.2 million to $41.5 million during that time. Total recapture payments in 2011 were down almost 2 percent from 2004.

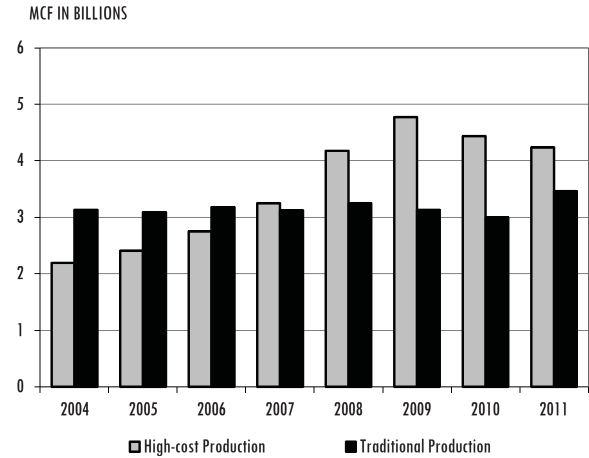
HIGH-COST GAS TAX-RATE REDUCTION

The state provides a number of deductions, exemptions, rate reductions, and allowances to the natural gas tax that reduce total state collections. These adjustments are primarily related to the method of production involved in drilling or transporting natural gas. The largest tax liability adjustment available to natural gas producers is the high-cost gas tax-rate reduction program. The program applies to qualifying wells completed after August 1996 and reduces the tax rate applicable to gas produced from the well. High-cost wells must first be certified by RRC, after which time the operator can apply to CPA for the applicable tax-rate reduction.

Texas statute cites federal law to define high-cost gas wells, specifically Title 15, United States Code, Section 3317, as it existed on January 1, 1989 (created by the Natural Gas Policy Act of 1978). Section 3317 was repealed by Congress on July 26, 1989, with the repeal effective January 1, 1993; however, the definition remains part of the Texas Tax Code. Before its repeal, the federal statute defined high-cost gas based on specific types of geological formations or the processes used to produce the gas, including: well completion locations greater than 15,000 feet; geo-pressured brine operations; occluded natural gas from coal seams; gas produced from Devonian shale deposits; and other conditions determined to be high-cost by the Federal Energy Regulatory Commission. RRC uses this definition to define specific geographic areas from which gas operations can be certified as high-cost. Each area must be anchored by at least one well that conforms to the statutory definition of high-cost gas production; area's larger than 12,500 acres must contain multiple certified wells. The effect of this definition is that all wells drilled within the Barnett Shale and the Eagle Ford Shale qualify as high-cost gas wells regardless of the actual drilling costs. During fiscal year 2009, drilling and completion costs for approved high-cost gas wells ranged from a high of $14.7 million to a low of $24,000.

As shown in **Figure 5**, since fiscal year 2007, production from high-cost natural gas operations has eclipsed traditional

FIGURE 5
NATURAL GAS PRODUCTION IN TEXAS BY TYPE
FISCAL YEARS 2004 TO 2011



SOURCE: Comptroller of Public Accounts.

gas production in Texas. High-cost wells are located in 134 of the state's 254 counties. Nearly one-quarter of the high-cost wells identified by CPA are located in the four counties identified by RRC as the core counties of the Barnett Shale—Denton, Johnson, Tarrant, and Wise counties. When the non-core counties are included, the Barnett Shale accounts for 30.3 percent of the state's active high-cost wells. Those counties in turn accounted for 30 percent of total natural gas production in fiscal year 2011.

Well certification by RRC allows a producer to obtain a reduction in the effective tax rate applied to natural gas produced from the specific well. Statute sets the reduction based on the drilling and completion cost of the well relative to twice the median cost of drilling and completion for certified high-cost Texas wells during the previous year. The reduction is allowed for 120 consecutive calendar months (10 years), beginning on the first day of production, or until the total value of the reduction equals 50 percent of the actual drilling and completion costs of the certified well, whichever occurs first.

As an example, consider the case of a new shale gas well site operating in the Barnett Shale, drilled during fiscal year 2011, which incurs total drilling and completion costs of $3.0 million. The fiscal year 2010 median drilling and completion cost for certified high-cost gas wells in Texas was $2.6 million. Based on the statutory-rate reduction calculation, this well, when certified as a high-cost operation by RRC, would be eligible for a rate reduction from the

statutory 7.5 percent to 3.2 percent. **Figure 6** shows the rate-reduction calculation for the certified high-cost gas well in this example. If, instead of the median, the mean drilling and completion costs of $3.3 million were used as the basis for calculating the reduction, the same well would be taxed at a rate of 4.1 percent. Production from the well would be subject to the reduced tax rate for a period of 120 consecutive months, or until the value of the reduction equals $1.5 million, half the total drilling and completion cost of the well. However, wells drilled at costs far less than the median cost would also qualify for some level of tax-rate reduction.

FIGURE 6
TAX-RATE REDUCTION EXAMPLE CALCULATION FOR HIGH-COST GAS WELL, 2011

Tax Rate – [Tax Rate (Actual Drilling Cost / (2 * Previous Fiscal Year Median Drilling Cost))]

.075 – [.075 ($3,000,000 / (2 * $2,615,268))]

.075 – [.075 ($3,000,000 / $5,230,536)]

.075 – [.075 (.5736)]

.075 – [.043]

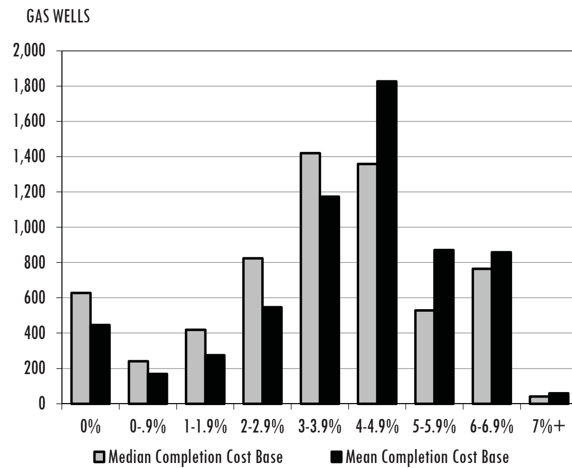
0.032 or 3.2 percent

Note: This example is based on a natural gas well drilled for $3,000,000 for which the operator applied to CPA for a rate reduction during fiscal year 2011.
Source: Legislative Budget Board.

During fiscal year 2011, the effective tax rate for all high-cost natural gas production was 1.8 percent. **Figure 7** shows the distribution of effective tax rates for high-cost gas wells approved during fiscal year 2009 and the distribution of effective tax rates if the mean drilling and completion costs were used instead of the median drilling and completion costs currently specified in statute.

Drilling costs for the 2,355 high-cost gas wells approved for rate reductions during fiscal year 2011 totaled $10.9 billion, creating the potential for lost state revenue of $5.4 billion through 2021. The impact of such losses is largest during initial years because of steep decline in production experienced by high-cost wells in later years. Based on an analysis of CPA data, approximately half of a typical well's first 120-month production occurs in the first two years, indicating that if price were constant for the 120-month period for which the well is eligible for the rate reduction then half of the tax benefit would occur in the first two years. Actual revenue losses could be below potential estimates depending on the ability of each completed well to reach sustainable production volumes. In practice, operators have tended to recover closer to 15 percent of drilling and completion costs through the high-cost gas rate reduction. Wells completed from 1997 to 2002 recovered from 13.4 percent to 19.2 percent of drilling and completion costs during their 120-month period of rate reduction eligibility on average. Only 2.5 percent of the 14,211 high-cost wells completed from 1997 to 2002 received the full 50 percent reduction.

FIGURE 7
DISTRIBUTION OF EFFECTIVE TAX RATES FOR HIGH-COST GAS WELLS APPROVED DURING FISCAL YEAR 2009



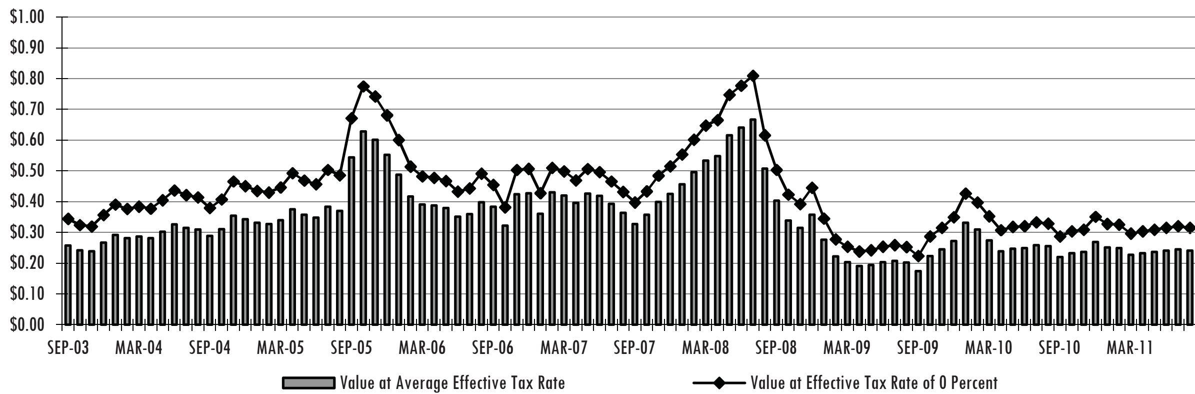
Sources: Legislative Budget Board; Comptroller of Public Accounts.

Recommendation 1 would amend the Texas Tax Code to require that the high-cost gas-rate reduction would be calculated by using mean drilling and completion costs from the previous fiscal year instead of median drilling and completion costs. Analysis of the sample of wells provided by CPA indicates that the low drilling and completion costs of some reduced rate eligible wells reduce the median and increase the tax benefit to many high-cost wells. This increases the revenue loss to the state.

VALUE OF THE RATE REDUCTION

The actual value of the rate reduction to any one operator is very difficult to predict. While the tax-rate reduction is dependent on the fixed costs associated with the drilling and completion of the well compared to the median fixed costs from the prior year and is therefore very predictable, the actual monetary value of the reduction is highly dependent upon the price of natural gas at any given time. **Figure 8** shows the monthly value of the rate reduction at the average effective tax rate of high-cost wells for each year, as well as the

FIGURE 8
VALUE OF THE HIGH-COST GAS-RATE REDUCTION (PER MCF), FISCAL YEARS 2004 TO 2011



SOURCES: Legislative Budget Board; Energy Information Administration; Comptroller of Public Accounts.

value of the rate reduction for wells with an effective tax rate of 0 percent. From fiscal years 2004 to 2011, the maximum value of the rate reduction at the average effective tax rate was $0.67 per Mcf in July 2008 when the price of gas was at historic highs and was at its lowest point in September 2009 at $0.17 per Mcf when gas prices were at their lowest point. The maximum benefit for wells taxed at an effective rate of 0 percent was $0.81 in July 2008 and the low was $0.22 in September 2009. In fiscal year 2012, the value of the rate reduction for wells taxed at an effective rate of 0 percent has ranged from $0.14 per Mcf to $0.29 per Mcf.

Not only is the value of the rate reduction highest to the operator when the price of gas is highest, as **Figure 9** shows, the level of forgone state revenue is also the greatest when gas prices are highest. When the price of gas peaked at an average of $10.79 in July 2008, the cost to the state of the rate reduction also peaked—costing the state $280.8 million in the same month. The average monthly price of natural gas exceeded $10.00 per Mcf three times from 2004 to 2012, in October 2005, June 2008 and July 2008. In those three months, the high-cost gas-rate reduction cost the state an average of $228.7 million per month in foregone revenue.

FIGURE 9
HIGH-COST GAS-RATE REDUCTION COST TO THE STATE BY PRICE OF NATURAL GAS, FISCAL YEARS 2004 TO 2012

PRICE OF NATURAL GAS (PER MCF)	MONTHS	TOTAL COST OF HIGH-COST RATE REDUCTION (IN MILLIONS)	PERCENTAGE OF TOTAL	AVERAGE MONTHLY COST TO THE STATE DUE TO RATE REDUCTION (IN MILLIONS)
$1.00 to $1.99	2	$56.5	0.6%	$28.2
$2.00 to $2.99	5	200.2	2.0	40.0
$3.00 to $3.99	14	963.1	9.6	68.8
$4.00 to $4.99	24	1,840.9	18.3	76.7
$5.00 to $5.99	26	2,091.8	20.8	80.5
$6.00 to $6.99	24	2,557.6	25.5	106.6
$7.00 to $7.99	1	152.4	1.5	152.4
$8.00 to $8.99	6	997.0	9.9	166.2
$9.00 to $9.99	3	498.2	5.0	166.1
$10.00 and above	3	686.2	6.8	228.7
Total	**108**	**$10,043.9**	**100.0%**	**$93.0**

SOURCE: Comptroller of Public Accounts.

By continuing to rely on definitions from the late 1970s for high-cost gas production, all production operations in the Barnett Shale and in the Eagle Ford Shale are classified as high-cost regardless of the actual costs incurred by producers and operators. High-cost natural gas production in Texas increased 93.0 percent from 2004 to 2011. High-cost gas production expanded from 41.2 percent of total state production in fiscal year 2004 to 55.0 percent of total gas production in fiscal year 2011. However, high-cost wells completed more recently are less productive on average than those completed only 10 years prior.

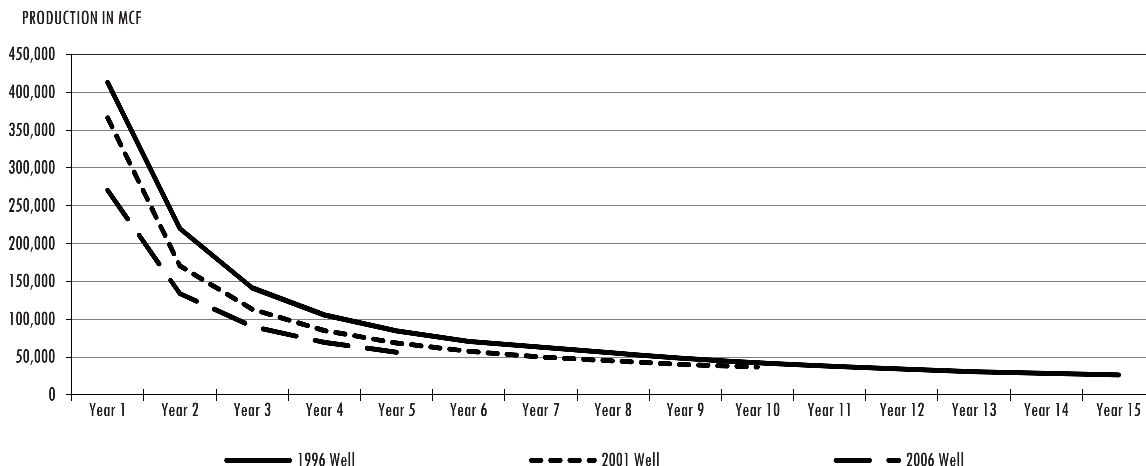
As **Figure 10** shows, wells are most productive in the first year of production and annual output declines significantly thereafter. Historically, production in year two is approximately half of production in the first year. Within two years, high-cost wells completed in 1996 had 44.3 percent of their total production to date. High-cost wells completed in 2001 had 52 percent of their total production within two years. High-cost wells completed in 2006 had 65.2 of their production in the first two years. Because production is so heavily concentrated in the first years of operation, it is reasonable to assume that the current price of gas and price expectations heavily affects the decision to drill or not to drill. This is the point at which the high-cost tax rate reduction could encourage a producer to drill at a price slightly lower than they otherwise would in the absence of the tax benefit. **Figure 11** shows that the number of new gas well permits tends to increase and decrease as the price of gas changes.

COST TO THE STATE

In fiscal year 2004, the revenue loss from high-cost gas tax-rate reductions topped $595 million. By fiscal year 2008, during a price spike in natural gas commodities, the loss to high-cost gas tax-rate reductions had grown to $1.97 billion. Essentially, the state did not collect 42 percent of total potential natural gas tax revenue during fiscal year 2008. Although rate reduction revenue losses decreased with commodity prices during fiscal year 2009, the value of the reductions remained above $1.0 billion. In fiscal years 2010 and 2011, the value of the rate reduction was worth close to $1.0 billion in each year and represented a loss of 51.0 percent of potential total natural gas production tax revenue.

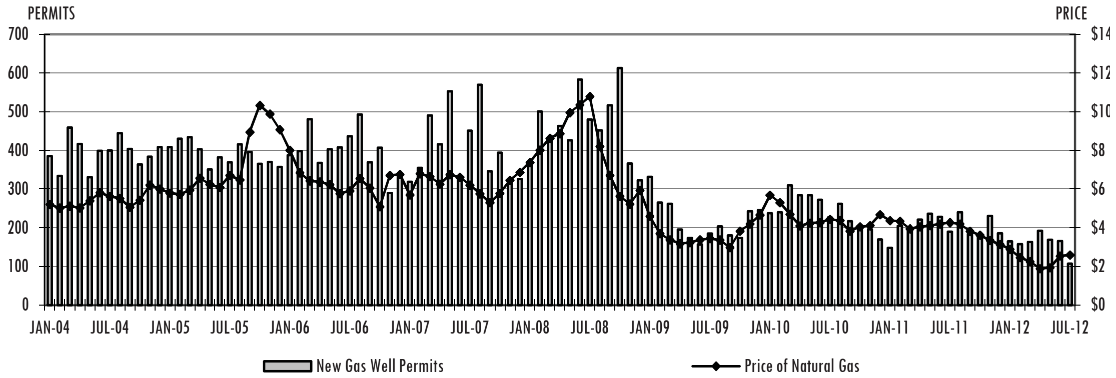
Figure 12 shows that when the cost of the high-cost rate reduction is included, the potential total value of the natural gas production tax would have been 5.4 percent of total state tax collections in fiscal year 2011. By statute, when a particular tax exceeds 5 percent of total collections, CPA is required to include that tax in the biennial *Tax Exemptions and Tax Incidence* report. In this report, CPA details the cost to the state of any exemptions associated with the tax and projects the value of the exemptions going forward. Due to the size of the high-cost rate reduction the natural gas production tax was not included in the 2011 edition of a report examining, at least in part, the cost of exemptions to the state. As a result, there have not been any published projections of the cost of the high-cost rate reduction to the state since February 2009 when the natural gas production tax met the requirements for inclusion in the 2009 edition of

FIGURE 10
TYPICAL HIGH-COST WELL ANNUAL PRODUCTION, BY YEAR OF COMPLETION



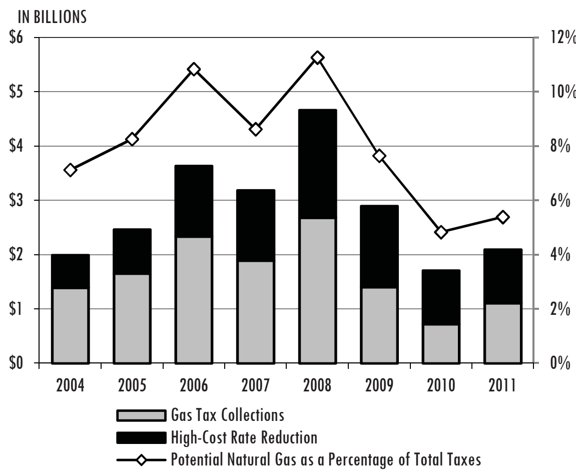
Source: Comptroller of Public Accounts.

FIGURE 11
NEW GAS WELL PERMITS BY MONTH, JANUARY 2004 TO JULY 2012



SOURCES: Railroad Commission of Texas; U.S. Energy Information Administration.

FIGURE 12
TOTAL POTENTIAL NATURAL GAS PRODUCTION TAX COLLECTIONS, FISCAL YEARS 2004 TO 2011



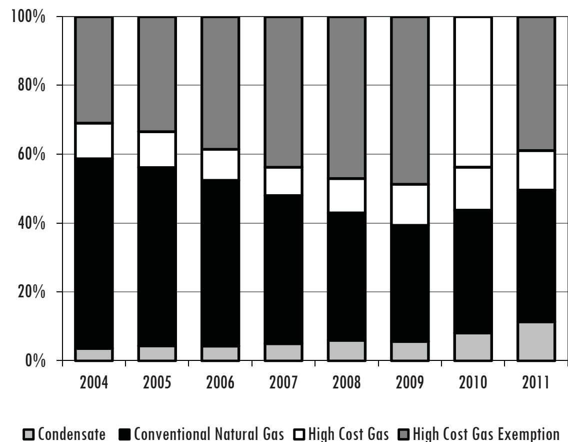
SOURCE: Comptroller of Public Accounts.

the report. In addition, because the same taxes are not always included in each report it is not always possible to review previous reports to gain context for current trends and projections.

Recommendation 2 would amend the Texas Government Code to require CPA to include the estimated value of exemptions, discounts, and exclusions, when identifying taxes for inclusion in the biennial *Tax Exemptions and Tax Incidence* report. Recommendation 2 would also require that CPA include any tax that has met the criteria for inclusion in the *Tax Exemptions and Tax Incidence* report in a previous fiscal year. This recommendation increases transparency related to the state's use of tax exemptions and prevents a tax from being excluded from the report due to associated exemptions, discounts, and exclusions being sufficiently large to push the tax below the 5 percent threshold.

Figure 13 shows natural gas production tax revenue by source (including foregone revenue due to the high-cost gas rate reduction) as a percentage of total possible revenue for fiscal years 2004 to 2011. The combination of low natural gas prices, high crude oil prices, and increasing condensate production in the Eagle Ford Shale may reduce the relative importance of the high-cost rate reduction to potential natural gas revenue. Despite being priced and taxed similarly to crude oil, the revenue from the tax on condensate production is included as part of the natural gas production

FIGURE 13
PERCENTAGE OF POTENTIAL NATURAL GAS PRODUCTION TAX REVENUE BY TYPE OF GAS
FISCAL YEARS 2004 TO 2011



SOURCE: Comptroller of Public Accounts.

tax. Condensate production is not eligible for a high-cost rate reduction.

ECONOMIC DEVELOPMENT INCENTIVE

The high-cost gas rate reduction clearly reduces costs for some natural gas producers. However, it is not clear whether or not this cost reduction leads to increased natural gas production or increased secondary economic activity. Legislative Budget Board staff used the REMI PI+ simulation model to model the impacts of eliminating the rate reduction at current prices and increasing government spending on education with the increased revenue and found that eliminating the rate reduction is associated with reduced employment in the mineral extraction sector and increased employment in the education sector. The model found a small negative impact on short-term total employment and a small positive impact on long-term employment. Unlike many industries in which businesses have great flexibility as to where they locate operations, natural gas extraction, like any resource extraction, is highly dependent upon the physical location of the resource. Because the tax benefit is administered as a tax-rate reduction, the benefit is most valuable when the price of natural gas is highest and in those situations a high market price, absent increases in the cost of production, is likely sufficient to incentivize production. Conversely, when the price of natural gas is lowest, the value of the rate reduction is also lowest. There may be some natural gas prices at which the high-cost gas-rate reduction incentivizes the production of natural gas that would not otherwise exist but we are unable to determine at what prices, if any, that this occurs. More information on the break-even price of natural gas production in the state is needed before that determination can occur.

Recommendation 3 would include a rider in the in the introduced 2014–15 General Appropriations Bill to require CPA to conduct a study to determine at what natural gas prices, if any, the high-cost gas-rate reduction incentivizes production. The study would consider the economic costs and benefits to the state of any increased production that is due to the rate reduction. Historically the cost of the rate reduction to the state has been highest in the months in which the average price of gas has been highest. It is likely that high natural gas prices would be sufficient to incentivize production without the assistance of an additional tax benefit. It is also likely that at very low gas prices the rate reduction would not be sufficient to incentivize added production. Additionally, if the rate reduction is an incentive to produce at low prices, the induced production would add to supply and likely further depress prices. Contingent upon the results of the study, the Legislature could amend statute to make the high-cost gas-rate reduction effective only at natural gas prices at which CPA has determined that the rate reduction incentivizes production that is economically beneficial to the state. CPA already administers the low producing well exemption, which is a price sensitive natural gas production tax benefit.

LESSONS FROM OUTSIDE TEXAS

Neighboring states Pennsylvania and West Virginia provide a case study in the importance of location in determining natural gas production. In 2004, Pennsylvania and West Virginia each produced close to 200,000 Mcf of natural gas, ranking 13th out of the 32 natural gas producing states. From 2004 to 2009, production in the two states increased at approximately the same rate—increasing by 34 percent in West Virginia and 39 percent in Pennsylvania. Production increased at a similar rate despite the fact that during this time, Pennsylvania did not have a severance tax on natural gas production and West Virginia taxed production at 5 percent of gross value. Due primarily to increased production in the Marcellus Shale play both states saw rapid production increases from 2009 to 2011, though Pennsylvania saw much more dramatic growth due to being located over more productive portions of the play. Natural gas production increased by 379 percent in Pennsylvania and increased by 49 percent in West Virginia. Both states expect record production again in 2012. Pennsylvania responded to the growth in natural gas production by instituting a Marcellus Shale impact fee of $50,000 for each horizontal well and $10,000 for each vertical well drilled each year at current natural gas prices, which generated $204.2 million in revenue.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations would increase the transparency regarding the cost of the high-cost gas-rate reduction and provide the Legislature with better information in the future to assess its efficacy.

Recommendation 1 would require the use of mean drilling and completion costs instead of median drilling and completion costs to calculate the high-cost gas tax benefit. Because this would reduce the impact that low-cost wells have on the calculation, this recommendation would result in a revenue gain to the State, but the fiscal impact cannot be estimated. Analysis of the sample of wells provided by CPA indicates that the low drilling and completion costs of some

reduced rate eligible wells reduce the median and significantly increase the tax benefit to many high-cost wells. In 2009, 14 percent of completed wells had drilling and completions costs that were above the median but below the mean. Using mean drilling and completions costs would have generated an additional $77.3 million from production in 2009 of wells completed in that year, of which $19.3 million would have been available as General Revenue Funds and $57.9 million would have been deposited into the Economic Stabilization Fund at the beginning of the next fiscal year.

Recommendations 2 and 3 would require CPA to perform additional analysis and administrative duties. This analysis assumes these duties could be completed using existing resources.

The introduced 2014–15 General Appropriations Bill includes a rider to implement Recommendation 3.

INDEX CERTAIN STATE TAXES AND FEES TO THE CONSUMER PRICE INDEX TO REDUCE LOSS OF PURCHASING POWER

Texas law includes multiple taxes calculated at a set rate per quantity sold of a taxable product rather than calculated as a percentage of the value of each sale. Because the rate per quantity does not increase with inflation, the tax eventually loses its relative value, thereby decreasing the purchasing power of state revenue collections. Texas' alcoholic beverage and tobacco excise taxes are examples of the decline in purchasing power of such structures. The Texas Legislature last modified alcoholic beverage tax rates in 1984. Since then, state excise taxes on sales of beer, wine, and distilled liquor lost more than half of their value due to their structure. Also, certain fees the state charges are set as flat amounts that will eventually lose purchasing power if not adjusted for inflation. While many fees are determined by an agency or governing board, others fees are determined by statute, such as certain professional fees and certificate of title fees.

Adjusting these tax rates and fees annually for changes in inflation, up to a maximum of 3 percent, would help maintain the purchasing power of revenue collections. Indexing the state's alcohol taxes, tobacco taxes, certain professional fees, and certificate of title fees to inflation would generate approximately $22.5 million in General Revenue Funds, $71.0 million in other state funds, and $2.7 million in local revenue during the 2014–15 biennium.

FACTS AND FINDINGS

- ♦ Texas' mixed beverage tax, which is the only alcohol tax rate based on the value of the product, has increased from 17.5 percent of total alcoholic beverage tax collections to 77.2 percent since 1972. During the same period, excise tax collections from beer sales decreased from 44.9 percent to 12.1 percent of total alcohol collections, while liquor tax revenue fell from 33.5 percent to 8.1 percent.
- ♦ Certain professional fees were last updated in 1991 and others were last updated in 2003. The services of most of these professionals are exempt from the sales tax.

CONCERNS

- ♦ Total inflation from 1984 to 2011 reduced the purchasing power of state excise tax collections from beer, wine, and distilled liquor by more than 50 percent. Without a change to their structure, these tax collections will continue to lose purchasing power.
- ♦ Although taxes levied on cigarette and other tobacco products have been adjusted by the Legislature more frequently than alcoholic beverage taxes, they retain quantity-based structures that make collections susceptible to value loss when the tax remains unchanged.
- ♦ Revenue from flat fees will continue to lose purchasing power if those fees are not updated to track with economy-wide inflation.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Amend statute to direct the annual adjustment of excise taxes on the purchase of beer, wine, distilled liquor, malt liquor and alcoholic beverages sold on aircraft and trains by the previous year's Consumer Price Index inflation rate, up to a maximum of 3 percent.
- ♦ **Recommendation 2:** Amend statute to direct the annual adjustment of excise taxes on the purchase of cigarettes, cigars, and other tobacco products by the previous year's Consumer Price Index inflation rate, up to a maximum of 3 percent.
- ♦ **Recommendation 3:** Amend statute to direct the annual adjustment of certain professional fees by the previous year's Consumer Price Index inflation rate, up to a maximum of 3 percent.
- ♦ **Recommendation 4:** Amend statute to direct the annual adjustment of the Motor Vehicle Certificate of Title Fee by the previous year's Consumer Price Index inflation rate, up to a maximum of 3 percent.

DISCUSSION

Texas' alcoholic beverage excise tax structure includes levies on six classifications of alcohol: mixed beverages; beer; distilled liquor; wine; malt liquor (ale); and any alcoholic beverages served on airlines or passenger trains within the state. From fiscal years 2001 to 2011, total excise tax collections in this category increased by 60 percent and

totaled $865.0 million in General Revenue Funds for fiscal year 2011.

Alcoholic beverage taxes in Texas originated in 1935 with taxes on wholesalers of beer, distilled liquor, malt liquor, and wine. These excise taxes, along with a tax (enacted in 1969) on alcoholic beverages sold on aircraft and passenger trains within the state, are based on a fixed rate per unit of alcohol sold. For example, wholesale taxes on beer purchases are taxed at a rate of $6.00 per barrel, regardless of the product's market value. With the exception of the airline/passenger train tax, which has not been adjusted since its enactment, these rates have not changed since being reset by legislation passed by the Sixty-eighth Legislature, 1984. Texas ranks at the bottom of national alcohol tax rates for distilled liquor and wine but falls slightly above the median for tax rates on beer sales. **Figure 1** shows rates, statutory references, and dates of interest for each of the state's alcoholic beverage taxes.

The state's mixed beverage tax was authorized by legislation passed by the Sixty-second Legislature, 1971, as an ad valorem tax of 10 percent of actual gross receipts. Subsequent legislatures adjusted the tax to 12 percent of gross receipts in 1984 and again to 14 percent in 1990. The Legislature has not adjusted the tax since 1990. The mixed beverage tax is the only alcoholic beverage tax in Texas levied as an ad valorem tax, calculated based on the value of the product at the time of sale rather than the quantity sold. This structure protects revenue from devaluation relative to inflation.

The difference in structure between the mixed beverage taxes and other state alcoholic beverage taxes contributes to the increasing proportion of the mixed beverage tax out of total excise tax collections. Mixed beverage taxes increased from 17.5 percent of total state alcoholic beverage tax collections in fiscal year 1972 to 77.2 percent in fiscal year 2011. During the same period, tax collections from beer sales decreased from 44.9 percent to 12.1 percent of total alcohol collections, while liquor tax revenue decreased from 33.5 percent to 8.1 percent. **Figure 2** shows the changing make-up of alcoholic beverage tax collections since fiscal year 1972.

Historical data shows the proportion of state collections of the mixed beverage tax increased relative to the other five alcoholic beverage taxes combined. Increases in sales volume, largely due to population growth and consumption changes, allowed state collections of the non-mixed beverage alcohol tax to increase during this period. However, these collections grew at a much slower rate than the mixed beverage tax, which has an ad valorem structure. While the unit value of the mixed beverage tax remains constant each year because it is based on the products market value, the real unit value of the other taxes decreased because they are not changing with product prices. From fiscal years 1985 to 2011, the beer tax remained unchanged at $6.00 per barrel, while inflation has averaged about 3.0 percent per year, totaling approximately 116 percent during the 27-year period. However, the rate the state collected on the products did not change, resulting in a loss of more than half the revenue's 1985 value. **Figure 3** shows the decline in real value of the tax on beer from fiscal years 1985 to 2011.

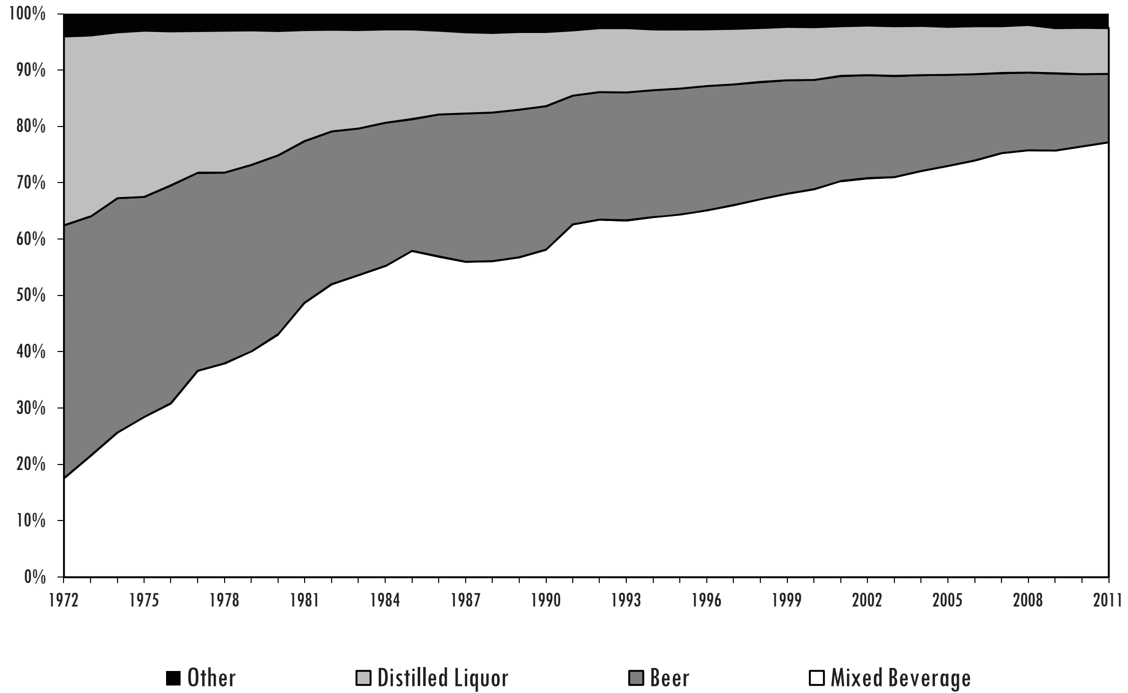
Recommendation 1 would adjust the state's alcoholic beverage taxes annually, excluding the mixed beverage tax, by the change in the previous calendar year's Consumer Price Index (CPI), up to a maximum of 3 percent. This adjustment would allow the state to better maintain the value of these tax collections, while ensuring any changes to ultimate retail prices on alcoholic beverages remain within general market parameters for all consumer products. The maximum of 3 percent is based on the average inflation since 1984, and would reduce the tax rate's volatility if economy-wide inflation exceeds that amount. By implementing this

FIGURE 1
TEXAS ALCOHOLIC BEVERAGE TAX STRUCTURE, FISCAL YEAR 2012

TAX CATEGORY	YEAR ENACTED	STATUTE	CURRENT RATE
Beer	1935	Texas Alcoholic Beverage Code, Section 203.01	$6.00 per barrel
Distilled Liquor	1935	Texas Alcoholic Beverage Code, Section 201.03	$2.40 per gallon
Wine	1935	Texas Alcoholic Beverage Code, Section 201.04	$0.204 to $0.516 per gallon
Malt Liquor (Ale)	1935	Texas Alcoholic Beverage Code, Section 201.42	$0.198 per gallon
Airline Purchases	1969	Texas Alcoholic Beverage Code, Section 34.04	$0.05 per serving
Train Purchases	1969	Texas Alcoholic Beverage Code, Section 48.04	$0.05 per serving
Mixed Beverages	1971	Texas Tax Code, Section 183.021	14 percent of gross receipts

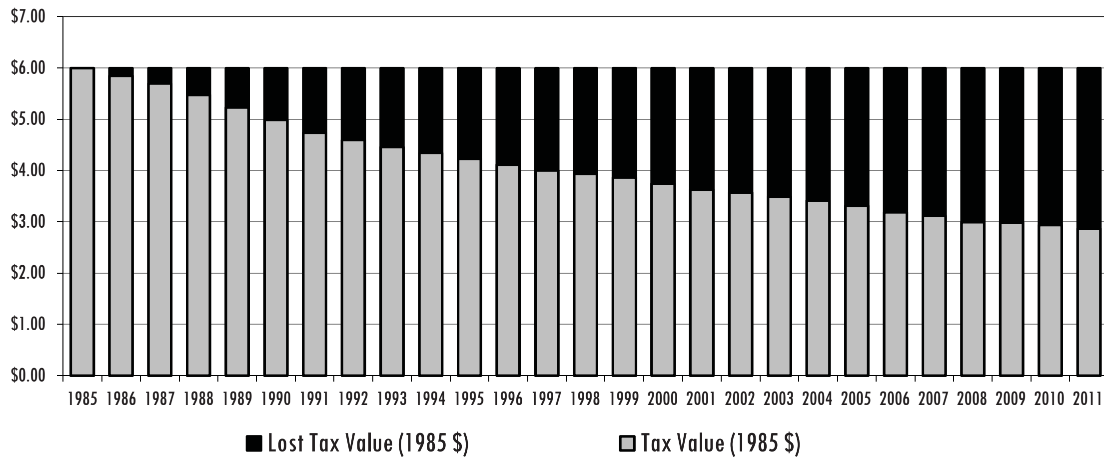
Sources: Texas Alcoholic Beverage Code; Texas Tax Code.

FIGURE 2
MAKE-UP OF TEXAS ALCOHOLIC BEVERAGE TAX COLLECTIONS, FISCAL YEARS 1972 TO 2011



NOTE: Other is a total of Malt Liquor (Ale), Wine, and Train/Airline.
SOURCE: Legislative Budget Board.

FIGURE 3
BEER UNIT TAX VALUE COMPARISONS
FISCAL YEARS 1985 TO 2011



SOURCE: Legislative Budget Board.

recommendation, the state would realize approximately $10.6 million in General Revenue Funds and $173,643 in local sales tax revenue during the 2014–15 biennium.

CIGARETTE AND TOBACCO TAXES

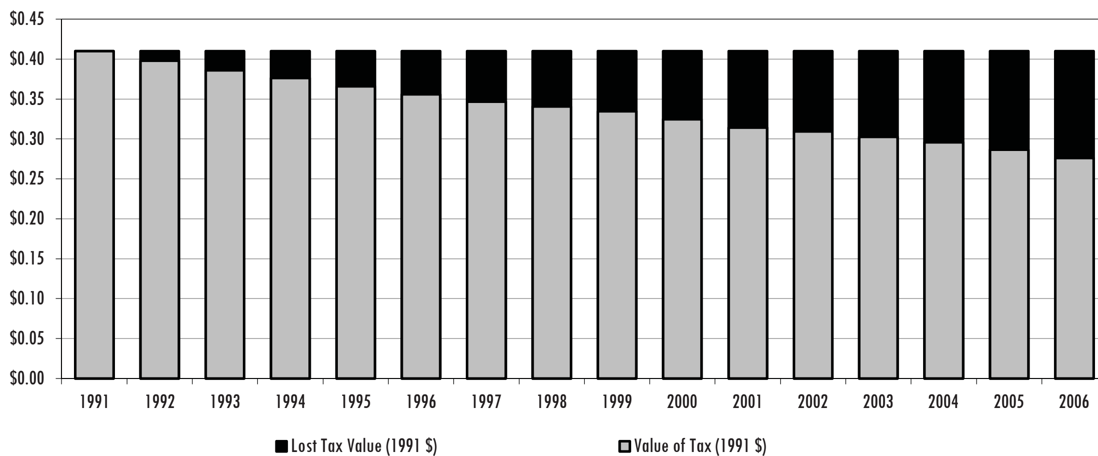
Texas taxes the purchase of cigarettes, cigars, and other non-cigar tobacco products, such as chewing tobacco. Total tax collections related to tobacco products totaled $1.56 billion in fiscal year 2011, with cigarette sales accounting for 89 percent. While fiscal year 2011 collections were 7.8 percent higher than fiscal year 2008 levels, collections declined from fiscal years 2009 to 2010, before moving higher again. Most significantly, cigarette tax collections, the largest element of total tobacco tax collections, remain below their fiscal 2009 peak of $1.45 billion. Sales increases of cigars and other tobacco products fill the gap.

The Forty-second Legislature, 1931, passed legislation that authorized the enactment of state's cigarette tax at a rate of $0.03 per pack. The rate has since been increased 11 times, most recently by legislation enacted in 2006. The tax is currently levied at $1.41 per pack. According to the Tax Policy Center, 22 states had cigarette tax rates higher than Texas as of fiscal year 2011. New York has the highest rate, with a $4.35 per pack tax and additional locally levied taxes of up to $1.50 per pack.

Although it has been adjusted throughout its history, the tax rate is calculated based on the quantity sold, not the product's market value, and therefore it could gradually lose value without regular legislative action. For example, from fiscal years 1991 to 2006 the cigarette tax remained unchanged at $0.41, but inflation was approximately 55 percent. Annual inflation during the period reduced the purchasing power of the tax by approximately 35 percent. **Figure 4** shows the loss in purchasing power of Texas' cigarette tax from fiscal years 1991 to 2006.

The Fifty-sixth Legislature, 1959, passed legislation that separated the cigar tax from the cigarette tax and set at rates varying from $0.001 to $0.015 per cigar based on the product's size, retail quantity, and composition. While the base-rate range has not changed for cigar sales, additional tax conventions have been added for non-cigar tobacco products, such as chewing tobacco, loose smoking tobacco, and snuff. Non-cigar tobacco rates were initially set at 28.125 percent of product prices, eventually rising to a high of 40 percent through legislation passed in fiscal year 2006. A restructuring of the tax altered it from an ad valorem basis to a quantity-structured basis by the Eighty-first Legislature, Regular Session, 2009, incrementally increasing the tax each fiscal year to a high of $1.22 per ounce in fiscal year 2014. Like the other taxes addressed in this analysis, the statutory structure of the state's tobacco taxes will lose relative value if they are not linked to inflationary changes or continuously adjusted through legislative action. Recommendation 2 would annually adjust the state's tobacco taxes by the change in the previous calendar year's CPI, up to a maximum of 3 percent, thus linking them to inflation. This change would increase state revenue by an estimated $7.4 million in General

FIGURE 4
CIGARETTE UNIT TAX VALUE COMPARISONS, FISCAL YEARS 1991 TO 2006



SOURCE: Legislative Budget Board.

Revenue Funds, $63.5 million in the Property Tax Relief Fund, $666,652 in the Physician Loan Repayment Program, and $1.2 million in local sales tax revenue during the 2014–15 biennium. Additional revenue collections to the Property Tax Relief Fund would reduce, by an equal amount, allocations of General Revenue Funds to the Foundation School Program.

ADDITIONAL OPPORTUNITIES FOR TAX INDEXING

In addition to the tax structures previously discussed, nine other Texas taxes could be adjusted to account for inflation and address tax collection value losses. **Figure 5** shows these taxes, their statutory rates, and total collections for fiscal year 2011.

CERTAIN PROFESSIONAL FEES

Texas charges certain professional fees for licenses or certificates to practice various professions. In 1991, the Seventy-second Legislature added an additional $200 fee for some of these professional licenses. In 2003, the Seventy-eighth Legislature extended that additional $200 fee to several more professions. This revenue is accounted for by the Comptroller using a single revenue code, Revenue Object Code 3171. **Figure 6** shows the professional fees in Revenue Object Code 3171 subject to this additional $200 fee. These fees are separate from professional fees accounted for under other revenue codes. Many other professional fees that are not subject to the $200 fee are set by agency boards or commissions and can therefore be adjusted more frequently if needed than those set in statute.

FIGURE 5
TAX DATA FOR ADDITIONAL RATE INDEXING OPPORTUNITIES, FISCAL YEAR 2011

TAX	RATE	2011 COLLECTIONS (IN MILLIONS)
Attorney Occupation	$200 per year per attorney	$13.7
Boat and Motor Boat Use	$15 per item	$44.9
Cement Production	$0.275 per 100 pounds	$6.1
Coin-Operated Machine	$60 per machine	$10.1
Diesel Fuel	$0.20 per gallon	$742.0
Gasoline	$0.20 per gallon	$2,361.1
Liquefied Gas	$0.15 per gallon	$1.0
Oil Regulation	3/16 of $0.01 per barrel	$0.7
Sulphur Production	$1.03 per long ton	$3.1

Source: Comptroller of Public Accounts.

The services of most of these professionals are exempt from the sales tax. Given that this $200 fee has not been raised since it was implemented, it has lost relative value due to economy wide inflation. **Figure 7** shows the lost value of the $200 fee since 1991.

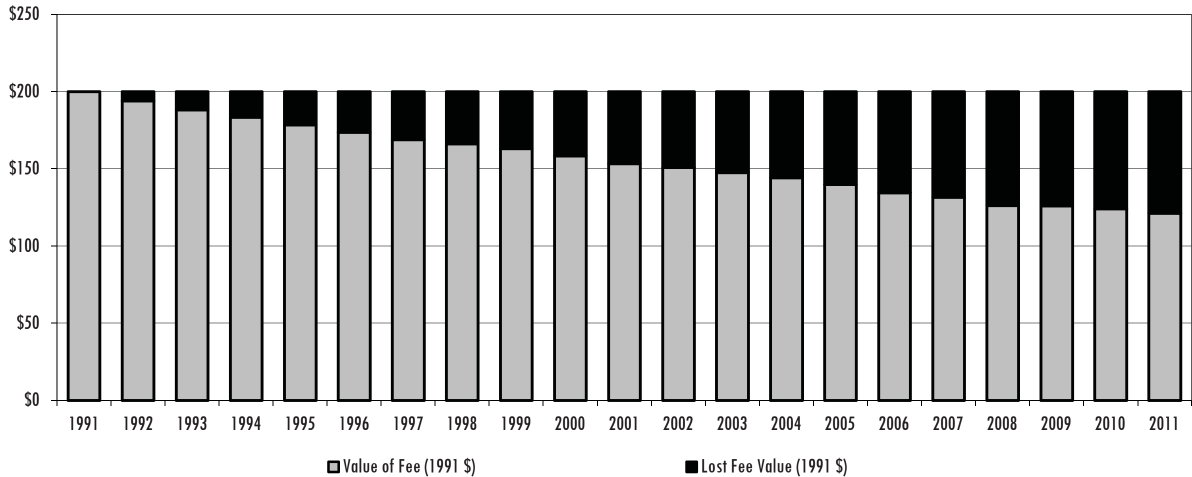
Recommendation 3 would amend statute to direct the annual adjustment of the fees that make up Revenue Object Code 3171 by the previous year's CPI inflation rate, up to a

FIGURE 6
PROFESSIONS SUBJECT TO $200 FEE IN REVENUE OBJECT CODE 3171

PROFESSION	COLLECTING AGENCY	EFFECTIVE DATE	TEXAS STATUTORY REFERENCE
Various Securities Professionals	Securities Board	1991	Article 581-41, Vernon's Texas Civil Statutes
Real Estate Broker	Real Estate Commission	1991	Texas Occupations Code, Section 1101.153
Accountants	Board of Public Accountancy	1991	Texas Occupations Code, Section 901.406, 901.407
Architects	Board of Architectural Examiners	1991	Texas Occupations Code, Section 1051.652
Engineers	Board of Professional Engineers	1991	Texas Occupations Code, Section 1001.206
Psychologists	Board of Examiners of Psychologists	1991	Texas Occupations Code, Section 501.153
Veterinarians	Board of Veterinary Medical Examiners	1991	Texas Occupations Code, Section 801.154
Property Tax Consultants	Department of Licensing and Regulation	2003	Texas Occupations Code, Section 1152.053
Landscape Architects	Board of Architectural Examiners	2003	Texas Occupations Code, Section 1052.0541
Interior Designers	Board of Architectural Examiners	2003	Texas Occupations Code, Section 1053.0521
Land Surveyors	Board of Professional Land Surveying	2003	Texas Occupations Code, Section 1071.1521

Source: Legislative Budget Board.

FIGURE 7
CERTAIN PROFESSIONAL FEE VALUE COMPARISONS, FISCAL YEARS 1991 TO 2011



Source: Legislative Budget Board.

maximum of 3 percent. This change would result in a gain of $3.2 million to the General Revenue Fund, $1.1 million to the Foundation School Fund, and $76,132 to the Texas A&M University Real Estate Research Center Local Fund in the 2014–15 biennium.

MOTOR VEHICLE CERTIFICATE OF TITLE FEE

The Motor Vehicle Certificate of Title Fee was established to "lessen and prevent the theft of motor vehicles," and was originally set in 1939 at $0.25. Since then it has undergone several changes, but the fee was most recently raised in 2003 to $33 for applicants who live in a county that is a nonattainment area according to the Clean Air Act and $28 for residents of all other counties. Counties keep $5 of the fee, and the remainder is allocated to the Texas Mobility Fund, the State Highway Funds, and the Texas Emissions Reduction Plan (TERP) fund. After the initial allocation, an amount equal to what is deposited into the Mobility Fund from this fee is transferred, using non-dedicated funds, from the State Highway Fund to the TERP fund. Recommendation 4 would amend statute to direct the annual adjustment of the Certificate of Title Fee by the previous year's CPI inflation rate, up to a maximum of 3 percent. If revenue were allocated using the same proportions and transfers as under current law, this recommendation would result in a net gain in state revenue of $1.3 million to the General Revenue Fund, $4.9 million to the TERP fund, and $3.9 million to the Texas Mobility Fund, and a net cost of $3.1 million to the State Highway fund in the 2014–15 biennium. This net cost to the State Highway Fund is the result of both a revenue gain of $788,572 and an increased transfer amount of 3.9 million from the State Highway Fund to the TERP fund. Texas counties would receive a revenue gain of $1.3 million.

ADDITIONAL OPPORTUNITIES FOR FEE INDEXING

In addition to the fees listed above, other fees could also be indexed to inflation to prevent a loss of purchasing power. **Figure 8** shows a non-exhaustive list of other fees that share the same structure and contribute to the General Revenue Fund.

FIGURE 8
FEE DATA FOR ADDITIONAL FEE INDEXING OPPORTUNITIES, FISCAL YEAR 2011

FEES	2011 COLLECTIONS (IN MILLIONS)
General Business Filing Fees	$66.1
Liquor Permit Fees	$30.8
Health-Related Professional Fees, House Bill 11 and Senate Bill 104 General Revenue Increase	$21.6
Concealed Handgun Fees	$13.8
Recovery of Parole Costs	$7.7
Commercial Transportation Fees—Commercial Motor Carriers	$5.4
Marriage License Fees	$5.3
Wine and Beer Permit Fees	$3.3

Source: Comptroller of Public Accounts.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendations 1 to 4 would generate an estimated net gain of $22.5 million in General Revenue Funds, $63.5 million to the Property Tax Relief Fund, $666,652 to the Physician Education Loan Repayment Program, $1.1 million to the Foundation School Fund, $76,132 to the Texas A&M University Real Estate Research Center Local Fund, $4.9 million to the Texas Emissions Reduction Plan fund, $3.9 million to the Texas Mobility Fund, $1.3 million to Texas counties governments, and $1.3 million in local sales tax revenue during the 2014–15 biennium in addition to a net cost of $3.1 million to the State Highway Fund. Additional revenue collections to the Property Tax Relief Fund would reduce, by an equal amount, allocations of General Revenue Funds to the Foundation School Program. The exact amount of new revenue depends on the actual percentage change in the annual CPI inflation rate during this period and the rate of applicable commodity sales during the biennium. **Figure 9** shows projected yearly revenue.

Recommendation 1 proposes annually adjusting state taxes on the purchase of beer, wine, distilled liquor, malt liquor and alcoholic beverages sold on aircraft and trains by the previous calendar year's CPI inflation rate, up to a maximum of 3 percent. This recommendation is estimated to generate $10.6 million in General Revenue Funds and $173,643 in local sales tax revenue during the 2014–15 biennium. The basis for the estimate considers the actual 30-year annual growth rates in alcohol sales and projected CPI inflation (1.69 percent to 2.04 percent). This estimate assumes Recommendation 1 could be implemented by using existing agency resources at no additional cost to the Texas Alcoholic Beverage Commission.

Recommendation 2 proposes annually adjusting state taxes on the purchase of cigarettes, cigars, and other tobacco products by the previous year's CPI inflation rate, up to a maximum of three percent. This recommendation is estimated to generate $7.4 million in General Revenue Funds, $63.5 million in the Property Tax Relief Fund, $666,652 in the Physician Loan Repayment Program, and $1.2 million in local sales tax revenue during the 2014–15 biennium. The basis for the estimate considers the recent annual growth rates in tobacco product sales and projected CPI inflation (1.69 percent to 2.04 percent). This estimate assumes this recommendation could be implemented by using existing agency resources at no additional cost to the Comptroller of Public Accounts and the Texas Alcoholic Beverage Commission.

Recommendation 3 proposes annually adjusting the fees that make up Revenue Object Code 3171 by the previous year's CPI inflation rate, up to a maximum of 3 percent. Rates would only be adjusted if the change would be greater than one dollar, and any new rate would be rounded to the nearest dollar. This change would result in a gain of $3.2 million to the General Revenue Fund, $1.1 million to the Foundation School Fund, and $76,132 to the Texas A&M University Real Estate Research Center Local Fund in the 2014–15

FIGURE 9
FIVE-YEAR FISCAL IMPACT OF INDEXING CERTAIN TAXES AND FEES
FISCAL YEARS 2014 TO 2018

	FISCAL YEAR				
PROBABLE REVENUE GAIN/(LOSS) TO:	2014	2015	2016	2017	2018
General Revenue Fund	$6,285,669	$16,225,282	$28,908,838	$42,671,985	$55,996,716
Property Tax Relief Fund	$20,129,357	$43,374,781	$71,602,104	$100,988,958	$127,547,499
Physician Education Loan Repayment Program	$50,368	$616,284	$1,351,390	$2,177,282	$2,997,608
Foundation School Fund	$353,943	$730,366	$1,256,225	$1,815,402	$2,409,864
Texas A&M University Real Estate Research Center Local Fund	$25,449	$50,683	$84,115	$117,265	$150,133
Texas Emissions Reduction Plan	$1,494,438	$3,394,706	$5,753,948	$8,311,947	$10,736,237
Texas Mobility Fund	$1,202,655	$2,731,903	$5,753,948	$8,311,947	$10,736,237
Local Sales Tax	$409,872	$936,166	$1,582,528	$2,264,532	$2,891,796
Counties	$400,885	$910,634	$1,543,504	$2,229,690	$2,880,009
PROBABLE SAVINGS/(COST) TO:					
State Highway Fund	($961,617)	($2,184,369)	($4,825,891)	($6,971,311)	($9,004,586)

Source: Legislative Budget Board.

biennium. The basis for the estimate considers the recent annual growth rates in these fees and projected CPI inflation (1.69 percent to 2.04 percent). This estimate assumes this recommendation could be implemented by using existing agency resources at no additional cost to the various agencies collecting these fees.

Recommendation 4 proposes annually adjusting the Certificate of Title Fee by the previous year's CPI inflation rate, up to a maximum of 3 percent. For the 2014–15 biennium, this change would increase state revenue by $1.3 million to the General Revenue Fund, $4.9 million to TERP, and $3.9 million to the Texas Mobility Fund. It would result in a cost to the State Highway Fund of $3.1 million Texas counties would receive a revenue gain of $1.3 million. The basis for the estimate considers the recent annual growth rates in this fee and projected CPI inflation (1.69 percent to 2.04 percent). This estimate assumes this recommendation could be implemented by using existing agency resources at no additional cost to the Texas Department of Motor Vehicles.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

CLARIFY ELIGIBILITY FOR THE EXEMPTION OF PROPERTY USED IN MANUFACTURING FROM THE SALES AND USE TAX

The sales and use tax is the state's largest source of General Revenue Funds, generating $24.2 billion in fiscal year 2012. Texas foregoes a significant amount of revenue due to various sales tax exemptions provided to businesses. The exemption of property used in manufacturing from the sales tax has the highest value of all sales tax exemptions. In fiscal year 2012, the estimated value of the exemption of property used in manufacturing was $11.1 billion. While statute stipulates the exemption of property used in manufacturing is for manufacturers, businesses other than manufacturers can claim the exemption. These businesses include grocers, restaurants, bakeries, and butcher shops.

Since the exemption was enacted, numerous lawsuits have been filed challenging the Comptroller of Public Accounts' interpretation of who may claim the exemption. The outcomes of these lawsuits have expanded the types of businesses and products eligible for the exemption. The state is at risk of losing potential sales tax revenue because of the ambiguity of the exemption and lawsuits seeking to expand eligibility for the exemption. Amending statute to expressly authorize the Comptroller of Public Accounts to clarify what types of businesses and property are eligible for the exemption of property used in manufacturing from the sales tax would help mitigate that risk.

FACTS AND FINDINGS

- ♦ According to the Comptroller of Public Accounts, the value of the sales tax exemption of property used in manufacturing is expected to total $25.4 billion for the 2014–15 biennium, approximately half of what the sales tax is expected to generate during the same period.
- ♦ The statutory provision relating to the exemption of property used in manufacturing does not define "manufacturer." Comptroller of Public Accounts' rules relating to the exemption defines "manufacturer" as someone engaged in manufacturing.
- ♦ The types of businesses or property that are eligible for the exemption of property used in manufacturing continues to grow, in some cases by including items which could be considered incidental to or in support of the manufactured product.

CONCERNS

- ♦ There is a lack of clarity on what businesses and property qualifies for the sales tax exemption of property used in manufacturing. This ambiguity poses a significant risk to the state in the potential loss of sales tax revenue.
- ♦ The Comptroller of Public Accounts has frequently had to defend against court challenges and tax appeals from businesses seeking to claim the exemption of property used in manufacturing. In fiscal year 2012, a district court affirmed the state's position that the equipment used to carry gas to the surface of the ground was ineligible for the exemption on property used in manufacturing (*Southwest Royalties, Inc. v. Susan Combs, Comptroller of Public Accounts*). This court case put the state at risk of being liable for more than $4 billion in General Revenue Funds over the next five years.

RECOMMENDATION

- ♦ **Recommendation 1:** Amend statute to expressly authorize the Comptroller of Public Accounts to clarify what businesses and property are eligible for the sales tax exemption of property used in manufacturing.

DISCUSSION

The Texas Tax Code, Chapter 151, levies the limited sales and use tax to the retail sale of products and many types of services. It is the largest source of tax revenue for the state, generating $24.2 billion in fiscal year 2012 and an estimated $22.7 billion in fiscal year 2013. The Texas Tax Code, Section 151.318, exempts tangible property from the sales and use tax "if sold, leased, or rented to, or stored, used, or consumed by a manufacturer." The exemption of property used in manufacturing (exemption) was established in 1961 to provide for the tax-free purchase of consumables used in the manufacturing of items. The purchase of packaging supplies for a manufactured product was also exempt. The exemption has grown to include machinery, equipment, and services performed on the product being manufactured, and maintenance on manufacturing equipment. According to historical records, proponents of the expansion of the

exemption claimed that it would serve as an incentive for major manufacturers to locate in Texas, and would generate state revenue by spurring growth in the manufacturing sector. The total value of the exemption for the 2014–15 biennium is an estimated $25.4 billion in General Revenue Funds. **Figure 1** shows sales tax revenue collections and estimated exemption values for fiscal years 1999 to 2013. Both the value of the exemption and revenue collections are expected to increase.

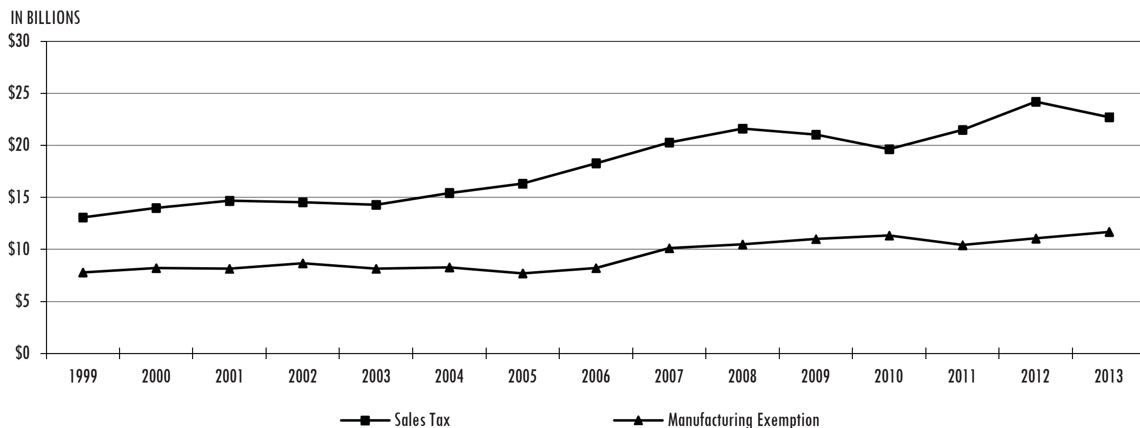
SALES AND USE TAX EXEMPTION FOR PROPERTY USED IN MANUFACTURING

While statute stipulates that the exemption of property used in manufacturing is for "manufacturers," not all of the businesses claiming the exemption are manufacturers, as defined by industry code. According to the Comptroller of Public Accounts' (CPA) *Tax Exemptions and Tax Incidence* report, an estimated 95.1 percent of the value of the exemption in 2013, or $11.1 billion, will be claimed by manufacturers, as defined by industry code. CPA estimates that approximately 2.6 percent ($303.7 million) will be claimed by the utilities and transportation sector, and 2.3 percent ($268.6 million) will be claimed by other service providers not typically recognized as manufacturers, such as restaurants, as shown in **Figure 2**.

In addition to the amounts estimated by the CPA for manufacturers, businesses in the mining and trade sectors can also claim the manufacturing exemption. These amounts are not included in the CPA's *Tax Exemptions and Tax Incidence* report, and the agency has not estimated the value of these claims. In general, the mining sector does not claim the exemption. However, two relatively narrow exceptions have been granted administratively by CPA that allow dynamite used by quarrying operations and certain soluble chemicals used in oil and gas mining to be eligible for the exemption. The trade sector includes grocers, who are eligible for and claim the exemption. The exemption applies to grocers because of the bakeries, butcher shops, and other prepared food areas that are sometimes part of their retail operation. In these cases, baking, cutting, and cooking food is considered manufacturing. This consideration allows stoves, heat lamps, vent systems, microwaves, and other equipment necessary for the preparation of food for sale, to be exempt from taxation. According to CPA staff, the estimated annual value of the exemption claimed by restaurants is reported in the total value of the exemption claimed by other service sectors, as shown in **Figure 2**. However, this amount does not include claims for the exemption by other businesses that sell prepared foods, such as grocers, since it is not estimated by CPA.

Of the $11.7 billion estimated value of the exemption in fiscal year 2013, claims for machinery and equipment are expected to account for $604.4 million, and claims for materials are expected to account for $10.7 billion. Statute also provides that supplies and materials used by manufacturers in packaging and wrapping products manufactured for sale are exempt. Claims for packaging and wrapping products are expected to total $332.3 million in

FIGURE 1
SALES TAX REVENUE AND VALUES OF THE EXEMPTION OF PROPERTY USED IN MANUFACTURING, FISCAL YEARS 1999 TO 2013



NOTE: Exemption values are estimated.
SOURCE: Legislative Budget Board.

FIGURE 2
DISTRIBUTION OF ESTIMATED VALUE OF MANUFACTURING EXEMPTION BY INDUSTRY, FISCAL YEAR 2013 (IN MILLIONS)

INDUSTRY	AMOUNT	PERCENTAGE
Mining	Not estimated	Not estimated
Trade (Wholesale and Retail)	Not estimated	Not estimated
Other Services	$268.6	2.3%
Utilities and Transportation	$303.7	2.6%
Manufacturing	$11,108.0	95.1%
Total	**$11,680.3**	**100.0%**

Source: Comptroller of Public Accounts.

fiscal year 2013. **Figure 3** shows the estimated value of the exemption for property used in manufacturing from fiscal years 2011 to 2016. The value of the exemption is expected to increase in the next biennium. Manufacturers are also eligible for other exemptions, such as the exemption of certain gas and electricity costs, including the gas and electricity used in manufacturing products for sale.

Figure 4 shows that the value of the exemption as compared to total sales tax revenue has averaged slightly above 50.5 percent in the past five fiscal years. The exemption amount for the 2012–13 biennium is estimated to be 48.5 percent of the $46.9 billion the sales tax is expected to generate during the same period.

CHANGES TO THE SALES AND USE TAX EXEMPTION FOR PROPERTY USED IN MANUFACTURING

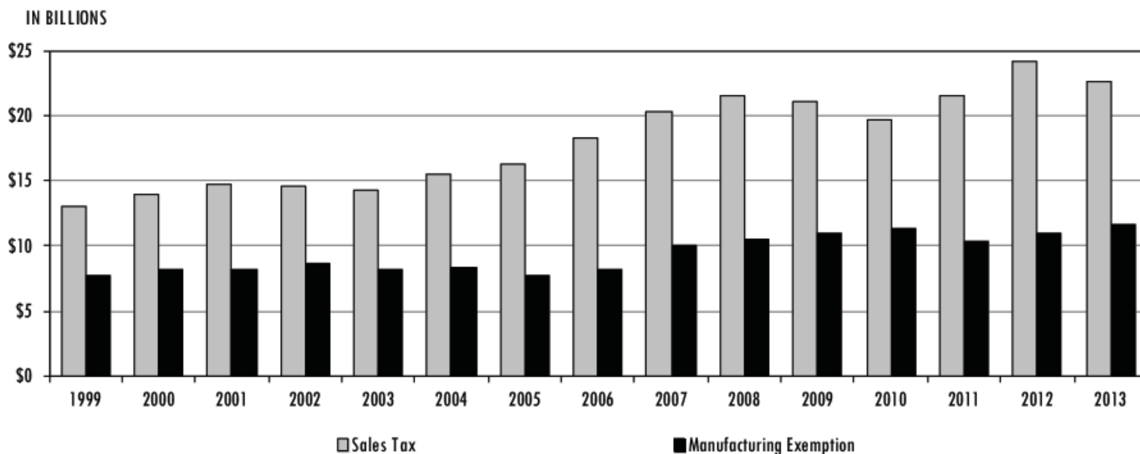
Initially, the exemption applied to only materials and manufacturing equipment with a life of six months or less used in the manufacturing of a product, effectively excluding much of the equipment being claimed under the exemption today. Since then, both legislative action and court decisions have modified the businesses and property that qualify for

FIGURE 3
VALUE OF EXEMPTION OF PROPERTY USED IN MANUFACTURING, FISCAL YEARS 2011 TO 2016 (IN MILLIONS)

PROPERTY USED IN MANUFACTURING	2011	2012	2013	2014	2015	2016
Materials	$9,573.8	$10,159.9	$10,743.6	$11,364.7	$11,983.4	$12,523.1
Machinery & Equipment	$538.6	$571.6	$604.4	$639.4	$674.2	$704.5
Packaging & Wrapping Supplies	$296.1	$314.2	$332.3	$351.5	$370.6	$387.3
Total	**$10,408.5**	**$11,045.7**	**$11,680.3**	**$12,355.6**	**$13,028.2**	**$13,614.9**

Source: Comptroller of Public Accounts.

FIGURE 4
VALUES OF THE EXEMPTION OF PROPERTY USED IN MANUFACTURING AND SALES TAX REVENUE, FISCAL YEARS 1999 TO 2013



Note: Exemption values are estimated. Sales tax revenue for fiscal year 2013 is estimated.
Source: Legislative Budget Board.

the exemption. **Figure 5** shows some of the significant changes to the exemption since its enactment.

The 1984 amendment that exempted services on manufactured items to make the items more marketable went beyond the previous statutory construction requiring that exempted property become an ingredient or component of the manufactured product. For example, with this amendment a lumber company could cut already manufactured wood to make custom moldings or picture frames and claim the exemption on the purchase of the equipment used for this activity. Claiming the exemption on equipment used to perform services on a manufactured product is an example of how the use of the exemption has been broadened to include certain activities and items that, at another time, would be considered incidental to or in support of the manufacturing of the product to be sold.

A primary element of the legal challenges to CPA interpretation of eligibility for the exemption is whether an item is considered a necessary component of the manufacturing process. In 1996, the 201st District Court ruled in favor of the plaintiff in *Chevron Chemical v. Sharp* and found that the piping used in the manufacturing of polyethylene (substance used to make plastic items) was a necessary component of the manufacturing process, and was being used as more than just intra-plant transport equipment. Based on this ruling, Chevron was entitled to a sales tax refund. In this case, CPA argued that although the piping in question was used as part of the manufacturing process, it

FIGURE 5
MAJOR CHANGES TO EXEMPTION ON PROPERTY USED IN MANUFACTURING, 1984 TO 2012

YEAR	CHANGE	IMPLEMENTATION
1984	Exemption expanded to include services performed on manufactured items to make them more marketable.	Legislative Action: House Bill 122, Sixty-eighth Legislature, Second Called Session
1987	Exemption expanded to include production machinery, equipment, parts, and accessories.	Legislative Action: House Bill 61, Seventieth Legislature, Second Called Session
1991	Exemption expanded to include machinery and equipment used in the production of newspapers distributed at short intervals, for the dissemination of news and distributed free of charge. The production of newspapers is defined as manufacturing.	Legislative Action: House Bill 1814, Seventy-second Legislature, Regular Session
1991	Limited the exemption of packaging materials that previously applied to all businesses to only manufacturers.	Legislative Action: House Bill 11, Seventy-second Legislature, First Called Session
1996	Exemption expanded to include equipment that is used in the preparation of items needed to produce the actual product to be manufactured.	Court Ruling: 126th District Court, *Tyler Pipe v. John Sharp, Comptroller of Public Accounts*
1996	Exemption expanded to include piping used to transport materials needed in the manufacturing of a product and was deemed as a necessary component of the manufacturing process when used in this manner.	Court Ruling: 201st District Court, *Chevron Chemical v. John Sharp, Comptroller of Public Accounts*
1997	Limited the exemption to machinery and equipment that is directly used in the actual manufacturing process, and directly makes or causes a chemical or physical change to the product being manufactured. Intra-plant transport equipment was specifically defined to include equipment used to move a product or raw material in connection with the manufacturing process. Piping and conveyor systems were identified as intra-plant transportation equipment that would not qualify for the exemption.	Legislative Action: House Bill 1855, Seventy-fifth Legislature, Regular Session
1999	Exemption amended to include a detailed, though not exhaustive, list of items that are exempt.	Legislative Action: House Bill 3211, Seventy-sixth Legislature, Regular Session
2012	Exemption does not apply to the equipment used in the extraction of uranium as claimed by plaintiff.	Court Ruling: 345th District Court, *Leoncito Plants, LLC v. Susan Combs, Comptroller of Public Accounts*
2012	Exemption does not apply to the equipment used in the extraction of oil and gas as claimed by plaintiff.	Court Ruling: 250th District Court, *Southwest Royalties, Inc v. Susan Combs, Comptroller of Public Accounts*

Source: Legislative Budget Board.

was used to transport materials needed in the manufacturing of polyethylene to another part of the plant, a use of equipment that is specifically excluded from the exemption in the Texas Tax Code, Section 151.318(c). Despite the specificity in statute, this case and others like it illustrate the lack of clarity regarding the property for which a claim for the exemption may be made. This ambiguity makes administration of the exemption complicated and burdensome for CPA, and difficult to interpret by CPA, businesses, and the courts.

The number of categories of property that may be claimed for exemption and the number of businesses filing those claims is increasing. The exemption has been amended to include semiconductor fabrication cleanrooms and equipment, certain uniforms, photographic props used in printing, and pharmaceutical biotechnology cleanrooms and equipment. Each additional item made eligible for exemption represents additional revenue being foregone by the state.

INTERPRETING ELIGIBILITY FOR THE EXEMPTION OF PROPERTY USED IN MANUFACTURING

The complexity in developing a definition that is explicit and sufficiently detailed to cover every exclusion or inclusion to the exemption is great, given that technology, equipment, and materials are constantly changing. The continued expansion of the exemption and legal challenges relating to its application are evidence of the constant evolution of this exemption and of the need for clarification of what businesses and property are eligible. These changes, coupled with a statutory construction that does not define "manufacturer," results in a lack of clarity which increases the risk to the state of future revenue loss.

The Texas Tax Code, Section 151.318, stipulates that the manufacturing process begins with the first activity that changes raw materials and ends with the packaging of the manufactured product, as it will be sold. CPA rules specify that the process does not include the preparation of materials for production. For example, a lumber company that cuts trees to manufacture wood cannot claim the equipment used to cut and collect the trees, sort it, and prepare it for the actual manufacturing process. The manufacturing process ends once the item has all physical properties it has when packaged and transferred from the manufacturing plant to a retailer or other location. Equipment and materials that would otherwise be exempt, if used in manufacturing, do not qualify for the exemption if used before or after the manufacturing process. Quality control equipment is exempt only if used for testing products during the manufacturing process before the product is complete and ready for sale. Eligibility for the exemption is based on when and how the equipment is used.

MANUFACTURING PROCESS CONSUMABLES

To qualify for the exemption, a material must be consumed in the manufacturing process either by becoming an ingredient or component of the product; or by directly making or causing a chemical or physical change to the product being manufactured, or to an intermediate or preliminary product that will become an ingredient or component part of the product being manufactured. In 1996, this statutory prerequisite for the exemption was at the center of a lawsuit, *Tyler Pipe Industries, Inc. v. Sharp, Comptroller of Public Accounts*. Tyler Pipe, a manufacturer of cast-iron pipes, argued that the purchase of items needed to make sand molds used in shaping pipes should be tax exempt. CPA asserted that while the mold itself would be exempt, the items used to make the mold would not be since they do not become a component part of the pipe nor do they directly cause a chemical or physical change to the pipe. The 126th District Court ruled against CPA and found that the production of molds is not a preparatory step. The court ruled, instead, that the production of molds is an early stage in the "actual manufacturing" of cast-iron pipes, making the purchase of items used to make the mold exempt. In response to this ruling and a similar case, *Chevron Chemical v. Sharp*, the Texas Legislature passed a statutory amendment that specified that, in order to qualify for the exemption, items must be "directly" used and "directly" cause a physical change to better align their expectations with statute.

Several other examples of the exemption of equipment not used directly in the manufacturing process exist. This contributes to the ambiguity in what businesses and property are eligible for the exemption, because while equipment not directly used in manufacturing is typically not eligible, in other cases equipment not directly used in manufacturing is eligible for exemption.

MANUFACTURING PACKAGING SUPPLIES

Statute provides that the packaging of an item is part of the manufacturing process, and that containers and packaging supplies purchased for the packaging of manufactured items for sale are exempt from the sales tax. For example, a manufacturer of dish soap must put its product in bottles to distribute to its customers. Prior to distribution, the bottle must be placed in boxes, then on pallets. The boxes must be

labeled and shrink wrapped for delivery. The manufacturer may purchase all of the supplies used for the packaging of the dish soap tax free. According to CPA staff, other examples of businesses that can purchase packaging tax free include laundry and dry cleaners, meat markets, bakeries, and newspaper publishers. These businesses are not typically considered manufacturers of products. Claims for packaging are estimated to be $722.1 million in General Revenue Funds during the 2014–15 biennium.

The lack of clarity on the application of the exemption to packaging materials was seen in a 2010 court case, *Home and Garden Party (HGP) vs. Susan Combs, Comptroller of Public Accounts*. HGP manufactures home decorating products for sale, and also purchases bulk-packaged items which it then repackages and redistributes to retailers. For example, HGP buys, in bulk, already manufactured items such as flowers, baskets, and wire, and assembles and repackages them as flower arrangements. HGP asserted that its purchase of packaging materials was exempt from sales tax because it is a "manufacturer" as defined by statute, and that packaging materials is a component part of the product that it sells. HGP also claimed that not only is it a manufacturer because of the products that it wholly manufactures in-house, but also because of the products on which it performs only "the final manufacturing stage--packaging." HGP argued that the act of packaging is a stage of operation constituting "manufacturing," and thus it is a "manufacturer" of the items that it purchases for reassembling. The Third Court of Appeals reversed a judgment from a lower court in which CPA was ordered to refund sales taxes to HGP. The Appeals Court agreed with the CPA's claim that HGP primarily repackages, rather than manufactures, most of the items that it sells. It also found that "repackaging" is not manufacturing, for purposes of the Texas Tax Code, Section 151.318, because it does not make or cause a physical change in the items themselves. Had the ruling not been reversed, businesses engaged in repackaging and reassembling items would have become eligible to claim the exemption on the purchase of these materials at a significant loss of state revenue.

RISK OF LITIGATION

While the Legislature has made efforts to clarify statute, and CPA has developed rules and defended the agency's interpretation against challenges in court and in administrative hearings, a lack of clarity about the eligibility to claim the exemption persists. This ambiguity increases the risk of significant revenue losses to the state.

A recent suit by Southwest Royalties illustrates the risk to the state caused by the lack of clarity about what businesses and property qualifies for the sales tax exemption of property used in manufacturing. In the spring 2012, the 250th District Court heard a lawsuit brought by Southwest Royalties, Inc against the state seeking a sales tax refund of $960,000 for its purchases of tubing, casing, and other well bore equipment used to extract oil and gas. They claimed that the purchase of this equipment qualified for the exemption. Southwest Royalties maintained that the drilling of the oil, while in the ground, and the casing, piping, and other materials used to drill are not only integral to its processing operation, but that the process directly caused chemical and physical changes to the product ultimately being sold. The company asserted that its processing activities began during the extraction process, contradicting existing CPA interpretation. CPA argued that the primary purpose of the drilling, and all other equipment used to drill, is to extract and carry liquid to the surface. Specifically excluded from the exemption is "intra-plant transportation equipment … used to move a product or raw material in connection with the manufacturing process and specifically including all piping and conveyor systems …." While CPA has acknowledged that chemical changes may occur at the well site, the agency has consistently taken the position that bringing oil or gas to the surface of the earth does not constitute processing, fabrication, or manufacturing.

The preliminary ruling favored Southwest Royalties. **Figure 6** shows the potential state revenue loss associated with the extension of the exemption to equipment used for mineral extraction, totaling $2.4 billion in General Revenue Funds from fiscal years 2013 to 2017.

According to CPA staff, this amount does not include a refund liability of $2 billion, plus interest, for the standard four-year statute of limitations period. This preliminary

FIGURE 6
POTENTIAL STATE REVENUE LOSS FROM EXEMPTION OF EQUIPMENT USED FOR MINERAL EXTRACTION
FISCAL YEARS 2013 TO 2017

FISCAL YEAR	GAIN/(LOSS) IN GENERAL REVENUE FUNDS
2013	($400,000,000)
2014	($440,000,000)
2015	($490,000,000)
2016	($530,000,000)
2017	($580,000,000)

Source: Comptroller of Public Accounts.

estimate of potential revenue loss only accounts for the loss due to mining industry activity, and does not account for the other industries that would have become eligible for the exemption based on this precedent.

Several weeks after the preliminary ruling for the plaintiff, however, the judge reheard arguments from both parties and later ruled in favor of the state.

Through court rulings, judges sometimes resolve differences between statutes and rules. Some court rulings have favored the taxpayer at a significant revenue loss to the state. Businesses have a vested interest in broadly and favorably interpreting certain statutes, often challenging CPA and the rules the agency has developed to enforce statute. The CPA must defend rules and policies against individual refund claims. According to CPA staff, the process is administratively burdensome and requires resources that could otherwise be used within the agency. The need for CPA resources for litigation purposes and challenges from businesses will continue to occur as long as there is no clear definition in statute and the CPA does not have explicit authority to clarify statute within the boundaries set by the Legislature.

Recommendation 1 would amend the Texas Tax Code, Section 151.318, to expressly authorize the CPA to clarify what businesses and property are eligible for the exemption of property used in manufacturing from the sales tax based on statutory provisions. This change would help mitigate the risk posed by future challenges seeking expansion of the exemption and associated potential state revenue losses.

Providing the Comptroller authority to interpret certain statutory language would not be unique if granted. For example, Texas Tax Code, Section 151.0101(b), allows the Comptroller to "interpret" laws related to taxable services. This section provides that: "The Comptroller shall have exclusive jurisdiction to interpret subsection (a) of this section" which lists which services are excluded or included as taxable services.

FISCAL IMPACT OF THE RECOMMENDATION

Recommendation 1, granting CPA authority to determine what businesses and property are eligible for the exemption, would have no significant fiscal impact. Granting CPA this authority would reduce the risk of state revenue loss posed by the potential expansion of the exemption through the court system.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of this recommendation.

RESTRUCTURE ANY FUTURE ROUNDS OF THE CERTIFIED CAPITAL COMPANY PROGRAM TO IMPROVE EFFICIENCY

The Certified Capital Company program is a state-sponsored economic development mechanism funded through deferred insurance tax credits. The state has implemented two rounds of the program with each round costing the state $200 million in tax credits. The credits began in fiscal year 2009, and the last credits will be available in fiscal year 2016.

Under the program, insurance companies invest in state-approved investment companies called certified capital companies. The insurance companies receive one dollar of deferred premium tax credits for each dollar invested in the capital companies. Over a period of years, each certified capital company invests a portion of its capital in small businesses called portfolio companies. Qualified investments must comply with certain restrictions and meet a statutory timeline. After satisfying its investments targets, a capital company can distribute all its funds to its owners. The current program will expire after the existing certified capital companies meet their investments requirements.

While the Certified Capital Company program has certain strengths, the program is inefficient. A significant portion of program revenue is used for purposes other than investment in portfolio companies. The state, the principal source of the revenue for the program, receives no direct benefit from the program. As a result, the program does not provide an ongoing source of venture capital in the state. If legislation creating a third round of the Certified Capital Company program is enacted, by amending statute to modify or restructure the program, the state can address the program inefficiencies.

FACTS AND FINDINGS

- Texas has implemented two rounds of the Certified Capital Company program that have resulted or will result in a combined revenue loss of $400 million to the state.
- As of December 31, 2011, certified capital companies had invested $282.5 million in 107 portfolio companies.
- The last insurance tax credits will become available in fiscal year 2016. The program will expire after current capital companies meet their investment requirements.

CONCERNS

- A significant portion of program funds is used for purposes other than investment in portfolio companies.
- The state has received no direct return from the Certified Capital Company program.
- The program structure fails to provide an ongoing source of revenue for economic development.
- Multiple certified capital companies can invest in the same portfolio company. If the investment of one certified capital company is used to pay off an earlier investment of a certified capital company, both investments count toward their investment targets.

RECOMMENDATION

- **Recommendation 1:** If a third round of the Certified Capital Company program is implemented, amend statute to address the Certified Capital Company program's inefficiencies. Options for modifying or restructuring the program include the following:
  - **Option 1:** increasing investment requirements;
  - **Option 2:** offering discounts for premium credits while prohibiting certified capital companies from making payments to insurance companies;
  - **Option 3:** requiring insurance companies to bid for tax credits while prohibiting certified capital companies from making payments to insurance companies;
  - **Option 4:** allowing the Texas Employee Retirement System to participate in the program through the purchase of securitized tobacco settlement payments; and
  - **Option 5:** returning a portion of program profits to the state.

DISCUSSION

The Certified Capital Company (CAPCO) program is a state-sponsored, economic development mechanism funded through insurance premium tax credits. In the Texas CAPCO program, insurance companies invest in state-approved

venture capital companies called certified capital companies or CAPCOs. The insurance companies receive one dollar of deferred premium tax credit for each dollar invested in CAPCOs. The insurance company investments in CAPCOs can be in the form of loans or equity. The insurance companies are repaid with a combination of interest and principal on loans to CAPCOs, equity, and tax credits.

Over a period of years, each CAPCO invests a portion of its certified capital in businesses called portfolio companies. CAPCO investments in portfolio companies must meet certain restrictions and timelines. When a CAPCO's cumulative investments in portfolio companies equal 100 percent of its certified capital, the CAPCO can distribute all its funds to its owners. The state receives no direct benefit from the program. The state and local governments may benefit indirectly from any gain in state and local taxes attributable to the portfolio companies. The flow of CAPCO funds is shown in **Figure 1**.

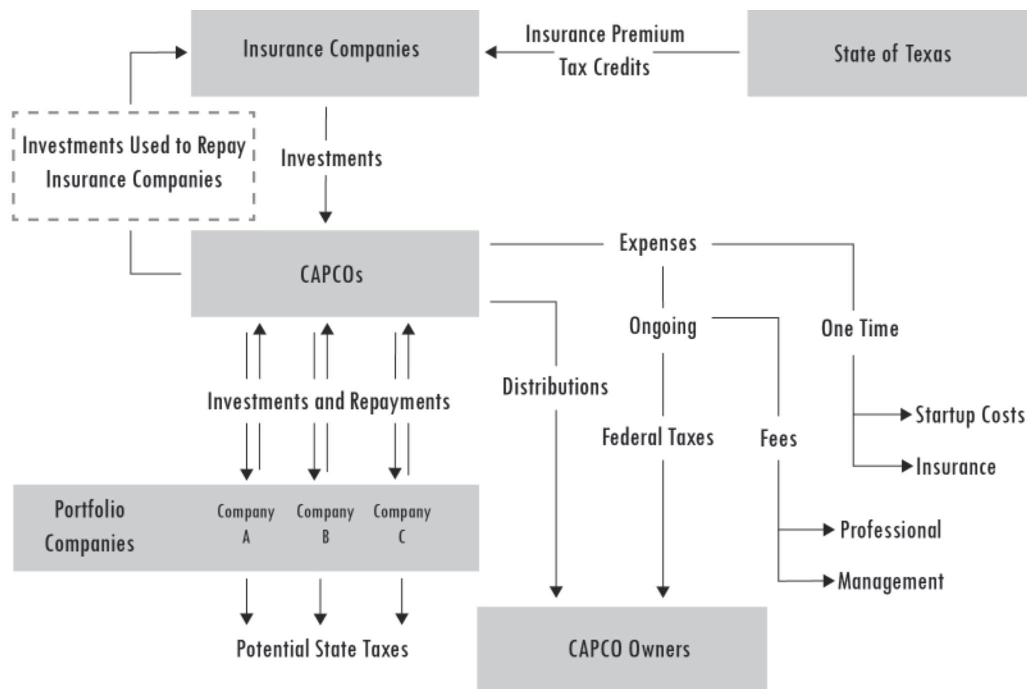
CAPCO REQUIREMENTS

Each applicant for certification as a CAPCO is required to have an equity capitalization of at least $500,000. The CAPCO is required to provide an independently audited balance sheet and pay a $7,500 application fee and an annual $5,000 renewal fee. The CAPCO must have at least two principals or employees with four years of experience in venture capital. Venture capital is funding for small businesses that have little or no access to capital markets. Venture capital firms provide most venture capital. These firms are usually partnerships that receive investments from individuals and various financial institutions. Frequently, venture capital firms assume active management roles in the companies in which they invest. Typically, the managers of venture capital firms receive a management fee, usually 2 percent annually, and a portion of the fund's net profits, usually 20 percent.

PORTFOLIO COMPANIES – QUALIFIED BUSINESSES

CAPCOs invest in small businesses called portfolio companies. There are several statutory restrictions on what investments count toward CAPCOs' required investment targets. At the time of a CAPCO's first investment, a qualified business must be headquartered and have its principal business operation in Texas. It must also intend to remain in the state after the CAPCO investment. The business must agree to use the investment primarily for operations in Texas. The company may not have more than 100 employees at the time of the initial CAPCO investment. It must have 80 percent of its employees or 80 percent of its payroll in Texas.

FIGURE 1
CERTIFIED CAPITAL COMPANY PROGRAM FLOW OF FUNDS, CALENDAR YEARS 2005 TO 2011



SOURCE: Legislative Budget Board.

The company must be primarily engaged in manufacturing, research and development, or providing certain services, such as custom computer programming and market consulting.

The business may not be primarily in retail sales, real estate, insurance, banking, lending, accounting, legal services, or physician services. A business that is a qualified business at the time it receives an initial CAPCO investment remains a qualified business and can receive subsequent qualified investments from any CAPCO. If a business no longer has its principal operation in Texas, it becomes ineligible for subsequent qualified investments.

CAPCOs can place certified capital not invested in portfolio companies in investments such as federally insured accounts, certificates of deposit, or government securities.

TEXAS CAPCO HISTORY

Texas has implemented two rounds of CAPCO, Program I and Program II. The first Texas CAPCO legislation was passed in 2001. As originally passed, insurance companies were to receive dollar-for-dollar insurance tax credits for investment in CAPCOs. The total amount of credits was capped at $200 million, to be taken $20 million per year beginning in fiscal year 2002. The legislation contained a provision making implementation of the program contingent on certification by the Comptroller of Public Accounts (CPA) that sufficient revenue was available to fund the credits. CPA did not provide the needed certification, and the program was not implemented at that time. Seventy-eighth Legislature, Regular Session, 2003, passed legislation that amended the original CAPCO statute to delay the insurance tax credits until fiscal year 2009 and increase the maximum annual credit to $50 million. This legislation repealed the provision that had made implementation subject to certification of available revenue.

Following this legislation, Texas CAPCO Program I was implemented in 2005 when CPA certified that 10 CAPCOs met the statutory requirements to participate in the program. The 10 CAPCOs and 98 insurance companies negotiated investment agreements seeking $1.76 billion in tax credits, 8.8 times the $200 million cap. As a result of the oversubscription, CPA prorated the credits among the competing CAPCOs. The insurance companies invested $200 million in certified capital in the CAPCOs in Program I, as shown in **Figure 2.** Program I insurance tax credits were limited to $200 million total and $50 million each year, as shown in **Figure 3**. Program I insurance tax credits were limited to $200 million total and $50 million each year, and

FIGURE 2
INSURANCE COMPANY INVESTMENT IN CERTIFIED CAPITAL COMPANIES
PROGRAM I - FISCAL YEAR 2005
IN MILLIONS

CERTIFIED CAPITAL COMPANY	AMOUNT OF CERTIFIED CAPITAL RECEIVED
Accent Texas Fund I, LP	$23.4
Aegis Texas Venture Fund, LP	$22.5
Enhanced Capital Texas Fund, LLC	$23.4
Lonestar CAPCO Fund, LLC	$8.6
Republic Holdings Texas, LP	$5.0
Stonehenge Capital Fund Texas, LP	$23.4
Texas ACP I, LP	$23.4
Waveland NCP Texas Ventures, LP	$23.4
Whitecap Texas Opportunity Fund, LP	$23.4
Wilshire Texas Partners I, LLC	$23.4
Total Program I	**$200.0**

Source: Comptroller of Public Accounts.

FIGURE 3
INSURANCE TAX CREDITS AUTHORIZED AND TAKEN
PROGRAM I
IN MILLIONS

FISCAL YEAR	INSURANCE TAX CREDITS AUTHORIZED	CREDITS TAKEN
2009	$50.0	$48.7
2010	$50.0	$48.7
2011	$50.0	$48.3
2012	$50.0	$47.3
Total Program I	**$200.0**	**$193.1**

Source: Comptroller of Public Accounts.

insurers have taken $193.1 million of the Program I credits, as shown in **Figure 3**. Credits not taken carry forward indefinitely.

Program II was implemented in 2007 when 81 insurance companies sought $1.58 billion in tax credits through investments in nine CAPCOs. As had been done in Program I, CPA prorated the credits to conform to the $200 million limit. **Figure 4** shows the amount of tax credits allocated to each CAPCO in Program II. The tax credits for Program II will begin in fiscal year 2013 as shown in **Figure 5**.

INVESTMENT TIMETABLE AND REQUIREMENTS

Cumulative investments in portfolio companies by each CAPCO must equal at least 30 percent of its certified capital

FIGURE 4
INSURANCE COMPANY INVESTMENT IN CERTIFIED CAPITAL COMPANIES
PROGRAM I - FISCAL YEAR 2007
IN MILLIONS

CERTIFIED CAPITAL COMPANY	AMOUNT OF CERTIFIED CAPITAL RECEIVED
Accent Texas Fund II, LP	$14.6
Aegis Texas Venture Fund II, LP	27.4
ATVF II LLC	4.0
Enhanced Capital Texas Fund II, LLC	27.4
Republic Holdings Texas II, LP	24.6
Stonehenge Capital Fund Texas II, LP	27.4
Texas ACP II, LP	27.4
Waveland NCP Texas Ventures II, LP	19.8
Whitecap Texas Opportunity Fund II, LP	27.4
Total Program I	**$200.0**

Source: Comptroller of Public Accounts.

FIGURE 5
INSURANCE TAX CREDITS AUTHORIZED
PROGRAM II
IN MILLIONS

FISCAL YEAR	INSURANCE TAX CREDITS AUTHORIZED
2013	$50.0
2014	50.0
2015	50.0
2016	50.0
Total Program II	**$200.0**

Source: Comptroller of Public Accounts.

within three years and 50 percent within five years. A CAPCO may reinvest proceeds received from a qualified investment. The reinvestments count toward the investment requirements. Each CAPCO must make cumulative investments of at least 25 percent of its certified capital in early stage businesses. Early stage firms must meet at least one of three criteria. They can be less than two years old, have gross receipts of less than $2 million, or be developing a new product or service. Each CAPCO must make at least 15 percent of its investments in strategic businesses, which are businesses in strategic investment areas as defined in the Texas franchise tax statute (Texas Tax Code, Chapter 171). A CAPCO is prohibited from making a single investment exceeding 15 percent of its certified capital. In addition to statutory requirements, CPA has imposed two important restrictions by rule. First, the CAPCO must have 50 percent of its certified capital available for investment in portfolio companies at the time of its formation and after insuring and defeasing its obligations. Second, loan agreements between the CAPCOs and portfolio companies must have a minimum term of two years. A CAPCO cannot distribute its assets to its owners until cumulative investments reach 100 percent of certified capital.

As of December 2011, CAPCOs had invested $282.5 million in 107 portfolio companies. **Figure 6** shows investment by each CAPCO in Program I and Program II. Sixty-eight percent of investments were in the form of debt, 17 percent in equity, and 15 percent in a combination of debt and equity. Reports to CPA indicate that three CAPCOs in Program I and two CAPCOs in Program II have made cumulative investments equaling 100 percent of their certified capital.

CAPCOs have invested in a wide variety of industries. The CAPCOs report the North American Industrial Classification System (NAICS) code of each of their portfolio companies to CPA. Manufacturing accounts for 26.1 percent of investments, followed by wholesale trade at 15.6 percent and the information sector at 15.5 percent as shown in **Figure 7**.

CAPCO investments have been concentrated in three counties—Travis, Harris, and Dallas. Sixty percent of the 107 portfolio companies are located in these counties, and 62.7 percent of the $282.5 million invested as of December 2011 had been invested in these counties. CAPCOs have invested $110.6 million in 33 portfolio companies located in Travis County. **Figure 8** shows the distribution of investments by county.

REQUIRED JOBS REPORT

Statute requires CAPCOs to report the number of jobs created and retained by their portfolio companies. There is not a statutory standard for measuring jobs created and retained. The jobs reports are not audited, but the reports are reviewed for reasonableness by CPA. CPA adjusts the aggregate jobs count to eliminate duplication when the same job is counted by multiple CAPCOs.

ADMINISTRATION OF THE PROGRAM

The CPA administers the Texas CAPCO program through Texas Safekeeping Trust Company. CPA is the sole shareholder and chair of the trust. The trust manages and invests the Texas Treasury Pool, two local government investment pools, and 12 endowment funds. Endowment

FIGURE 6
INVESTMENTS IN QUALIFIED BUSINESSES (PORTFOLIO COMPANIES)
CALENDAR YEARS 2005 TO 2011
IN MILLIONS

	2005	2006	2007	2008	2009	2010	2011	TOTAL
CAPCO Program I								
Accent Texas Fund I, LP	$1.5	$2.9	$6.6	$7.1	$5.1	$0.2	-	$23.4
Aegis Texas Venture Fund, LP	4.9	6.5	6.2	0.9	1.0	3.1	-	22.6
Enhanced Capital Texas Fund, LLC	-	5.3	1.8	4.7	-	5.5	$3.5	20.7
Lonestar CAPCO Fund, LLC	-	2.0	1.9	0.4	-	-	-	4.3
Republic Holdings Texas, LP	1.5	1.2	0.6	0.2	1.2	-	0.1	5.0
Stonehenge Capital Fund Texas, LP	-	2.5	4.6	3.8	1.1	-	-	12.0
Texas ACP I, LP	1.2	2.1	4.8	4.0	-	3.5	-	15.7
Waveland NCP Texas Ventures, LP	-	4.9	3.9	1.2	1.7	0.2	-	11.9
Whitecap Texas Opportunity Fund, LP	0.9	3.0	3.4	4.5	-	0.0	-	11.8
Wilshire Texas Partners I, LLC	12.0	-	-	2.3	0.9	0.6	5.4	21.1
Total Program I	**$22.1**	**$30.5**	**$33.8**	**$29.0**	**$11.0**	**$13.1**	**$9.0**	**$148.5**
CAPCO Program II								
Accent Texas Fund II, LP				$4.4	$7.5	$2.7	-	$14.6
Aegis Texas Venture Fund II, LP				7.6	6.7	5.1	$43.3	22.7
ATVF II LLC (Texas Ventures)				2.4	1.3	-	0.8	4.5
Enhanced Capital Texas Fund II, LLC				0.4	3.6	12.4	6.1	22.5
Republic Holdings Texas II, LP				3.7	11.1	3.7	1.4	19.9
Stonehenge Capital Fund Texas II, LP				0.1	1.0	7.4	3.2	11.6
Texas ACP II, LP				1.8	4.1	8.2	1.8	15.8
Waveland NCP Texas Ventures II, LP				-	6.0	3.3	1.9	11.1
Whitecap Texas Opportunity Fund II, LP				-	0.7	7.6	3.0	11.2
Total Program II				**$20.4**	**$41.9**	**$50.3**	**$21.3**	**$133.9**
Total Programs I and II	**$22.1**	**$30.5**	**$33.8**	**$49.4**	**$53.0**	**$63.4**	**$30.3**	**$282.5**

Source: Comptroller of Public Accounts.

portfolios are invested in fixed-income assets, long-term equity investments, hedge funds, and private equity.

The CPA is responsible for initial certification of CAPCOs. CPA prorates insurance tax credits if the program is oversubscribed, as has been the case in both Programs I and II. CPA, upon request of a CAPCO, evaluates any proposed investment to determine if it is a qualified investment.

The CPA conducts an annual review of each CAPCO and, after required notification and hearing, can decertify any CAPCO that is not meeting certain statutory investment requirements. Decertification of a CAPCO can result in forfeiture or recapture of insurance company tax credits. The amount of credits recaptured depends on when the CAPCO is decertified and which investment targets have been met. To date, no Texas CAPCOs have been decertified, and no insurance tax credits have been forfeited or recaptured. CPA is not authorized to audit CAPCOs. Without audit authority, it would be difficult for CPA to adequately substantiate violations that might cause forfeiture or recapture. CPA produces a biennial report to the Texas Legislature on the CAPCO program.

STRENGTHS OF THE CAPCO STRUCTURE

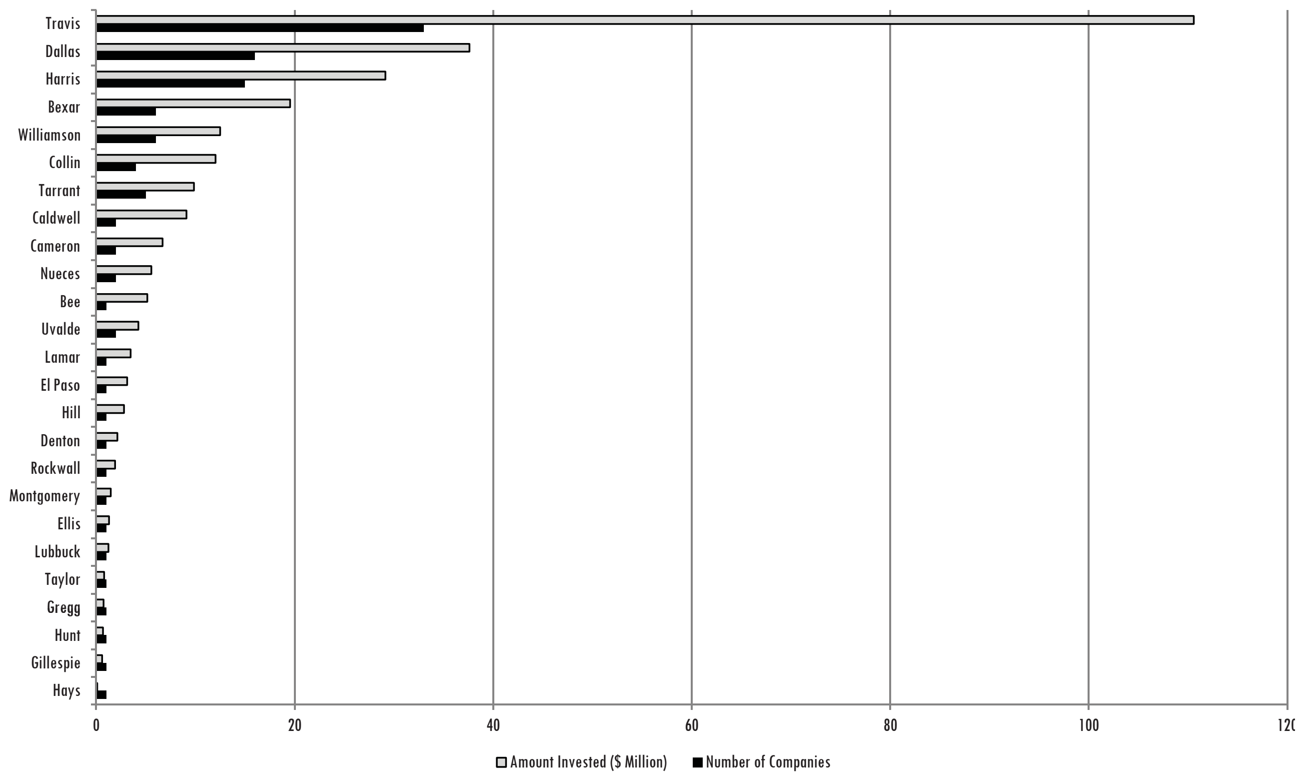
The CAPCO structure has several strengths. First, the government does not make direct investments in the portfolio companies. Insurance companies select the CAPCOs in which they wish to invest. The CAPCOs select the portfolio companies in which they invest. The role of the state is limited to certification, and monitoring CAPCO compliance

FIGURE 7
INVESTMENT BY INDUSTRIAL SECTOR THROUGH CALENDAR YEAR 2011 IN MILLIONS

SECTOR	INVESTMENTS	PERCENTAGE OF TOTAL
Manufacturing	$73.8	26.1%
Wholesale Trade	44.1	15.6
Information	43.7	15.5
Mining, Quarrying, and Oil and Gas Extraction	31.3	11.1
Administrative and Support and Waste Management and Remediation Services	19.3	6.8
Professional, Scientific, and Technical Services	18.0	6.4
Construction	17.2	6.1
Health Care and Social Assistance	13.1	4.6
Other	22.1	7.8
Total Investments	**$282.5**	**100.0%**

Source: Legislative Budget Board.

FIGURE 8
CAPCO INVESTMENTS BY COUNTY, INVESTMENT AMOUNTS IN MILLIONS, CALENDAR YEARS 2005 TO 2011



Source: Legislative Budget Board.

with legal requirements. This limited role reduces the appearance of political influence in the process of selecting portfolio companies. Second, the program is funded through deferred tax credits. This deferment allows CAPCOs to invest in portfolio companies to begin before the state experiences revenue losses. Additionally, the CAPCO investments require no appropriations and no bond sales. Third, the portfolio companies can benefit from the venture capital experience and expertise of the CAPCO managers. Fourth, CAPCO investments are from insurance company funds; funds that might not ordinarily be invested in venture capital. Finally, the forfeiture and recapture provision provides the state with a way to recover tax credits if CAPCOs do not meet their investment requirements. This strength is mitigated by the CPA's lack of audit authority.

INEFFICIENCIES OF THE CAPCO STRUCTURE

Several features of Texas' CAPCO program make it inefficient. A significant portion of the certified capital is used for purposes other than investment in portfolio companies. A substantial percentage of certified capital is set aside by CAPCOs in low-risk investments and used to repay loans from insurances companies. CAPCOs typically purchase third-party insurance to indemnify insurance companies' investments and tax credits. CAPCOs can charge an annual management fee of 2.5 percent of certified capital. The CAPCOs can spend up to 1 percent of certified capital each year on professional services. CAPCOs can pay the taxes attributable to the CAPCO income, including the federal personal income taxes of CAPCO partners.

In Program I, CAPCOs spent or set aside $88.7 million to organize, repay insurance companies, and insure debt. This left $111.3 million available for investment in portfolio companies at the time the CAPCOs were formed. Through December 2011, Program I CAPCOs spent $45.1 million on management fees, professional fees and services, and federal taxes. Program I CAPCOs used $133.8 million for purposes other than investment in portfolio companies through calendar year 2011. In Program II, CAPCOs used or set aside $87.3 million to organize, repay insurance companies, and insure debt. This left $112.7 million available for investment in portfolio companies. As of December 31, 2011 the CAPCOs in Program II spent another $20.9 million for ongoing expenses. **Figure 9** shows Program I and Program II set asides and expenses. CAPCOs use various accounting methods, making a precise consolidation of their financial reports difficult. Amounts in Figure 9 and in the summary above are based on information reported by the CAPCOs and compiled by CPA.

A CAPCO can meet the required investment timetable while investing only a small percentage of its certified capital in portfolio companies. This is because the aggregate or cumulative amount of all qualified investments made by a CAPCO counts in the computation of investment requirements. A CAPCO may reinvest proceeds received from a qualified investment. When a CAPCO reinvests proceeds from a prior qualified investment, the reinvestment counts toward the CAPCO's investment requirements. As a result, a CAPCO can achieve its investment requirement while using only 20 percent of its certified capital to invest in portfolio companies.

FIGURE 9
AMOUNT SPENT OR SET ASIDE FOR PURPOSES OTHER THAN INVESTMENT IN PORTFOLIO COMPANIES
CALENDAR YEARS 2005 TO 2011
IN MILLIONS

	PROGRAM I	PROGRAM II
Amount Expended on forming syndicating and organizing the CAPCO	$5.8	$3.8
Amount Expended to insure the CAPCO's qualified debt instruments	11.1	8.1
Amount set aside or expended to defease qualified debt instruments	71.8	75.4
Subtotal, Spent or Set Aside for CAPCO Formation, Repayment of Debt and Insurance	**$88.7**	**$87.3**
Amount expended on professional fees and services	$3.5	$2.6
Amount expended on management fees	29.9	16.9
Amount expended on projected federal tax increases of equity owners	11.7	1.4
Subtotal, Ongoing Expenses	**$45.1**	**$20.9**
Amount Spent or Set Aside for Purposes Other than Investment in Portfolio Companies	**$133.8**	**$108.2**

Source: Legislative Budget Board.

For the purpose of illustration, assume that a CAPCO has $20 million in certified capital. The CAPCO can comply with the investment timetable by using only $4 million of its certified capital for qualified investments. The CAPCO can achieve this by making a series of two-year loans to portfolio companies. The CAPCO loans $2 million in year one and $2 million in year two. By the end of year three, the loans made in year one are repaid and used to make another $2 million in loans. Cumulative investments total $6 million or 30 percent of certified capital, satisfying the CAPCO's three-year investment requirement. By the end of year four, the year-two loans are repaid and used to make another $2 million in loans. In year five, the year-three loans are repaid and used to make another $2 million in loans. At the end of five years, the cumulative investments by the CAPCO equal $10 million, meeting the requirement that 50 percent of certified capital be invested within five years.

In a related issue, multiple CAPCOs can invest in the same portfolio company. If the investment of one CAPCO is used to pay off an earlier investment of another CAPCO, both CAPCOs can count the investment toward their targets. To illustrate, CAPCO "A" makes a $1 million loan to a portfolio company. Then CAPCO "B" makes a $1 million loan to the same portfolio company, who then repays CAPCO "A" for the initial loan using the proceeds of the loan from CAPCO "B". Each CAPCO would be able to count a $1 million investment towards their investment requirements. The ability of CAPCOs to make such investments is a valid tool in many cases, but the practice could be abused to meet investment targets.

The state, the ultimate source of funding for the program through the provision of tax credits, receives no direct return for its investment. The state receives only the indirect gain from added state and local tax collections, if any, from the portfolio companies. In contrast, the typical venture capital investor receives 100 percent of their original investment and 80 percent of profits. The venture capital firm, generally, receives an annual management fee of 2 percent. The firm typically retains only 20 percent of profits. The CAPCOs receive a 2.5 percent management fee, any certified capital they have not spent or lost, and 100 percent of profits on its investments. If the CAPCO program were structured like a traditional venture capital investment, the successful CAPCOs would return the state's initial investment and a portion of CAPCO profits. This arrangement would provide an ongoing source of venture capital for the state.

OTHER STATES WITH CAPCO PROGRAMS

According to the National Conference of State Legislatures, nine states and the District of Columbia have implemented CAPCO programs. Some states have implemented several rounds of the program. Some states have adopted variations of the typical CAPCO program or modified their programs.

LOUISIANA CAPCO

The first CAPCO legislation was enacted in Louisiana in 1983. The program in Louisiana gradually evolved into a form similar to programs that were later adopted by other states. Louisiana's original program provided 20 percent income tax credits for CAPCO investments. In 1984, the income tax credit was increased to 35 percent. The program was expanded to provide a 200 percent insurance tax credit, but the credit was later reduced to 120 percent, and then to 110 percent. Key to the Louisiana program was the development of a strategy to guarantee the insurance company investments. The strategy involved the CAPCOs investing a portion of their certified capital in low-risk bonds and using the income from those investments and the tax credits to repay the insurance companies. In addition, the CAPCOs arranged third-party insurance to guarantee the insurance company's investments and tax credits. Under this strategy, the insurance companies were virtually guaranteed a higher than market rate of return on their CAPCO investments.

MISSOURI CAPCO

Missouri enacted CAPCO legislation in 1996. The program provided $50 million in insurance tax credits to be allocated in 1997 and $50 million in 1998. The program was later expanded to authorize an additional $40 million in credits in 1999. The credits were to be taken up to 10 percent per year for 10 years. In 2003, the Missouri General Assembly later revised the program to allow the CAPCOs to count investments made by affiliates toward the investment requirements.

A 2000 study commissioned by three Missouri groups—the Growth Capital Alliance, the Regional Commerce and Growth Association, and Technology Gateway —was conducted by the IC² Institute, University of Texas at Austin. The study concluded that the program had benefited the Missouri economy. The study estimated that the $40 million the CAPCOs invested at two and one-half year period had induced $387 million in additional investments in the portfolio companies. The study projected the CAPCO

program would generate 29,231 new direct jobs and 18,769 indirect jobs by the end of year 2017.

In 2004, a study sponsored by the Missouri Chamber of Commerce and the Growth Capital Alliance concluded that the program appeared to be one of the most effective economic development incentives Missouri had implemented. The study estimated the program had added in excess of 8,000 job-years of employment and generated $180 million in state and local tax revenue.

In contrast to the two industry-funded studies, an evaluation by the Missouri state auditor published in 2004, concluded that the Missouri CAPCO program was inefficient and ineffective. According to the auditor's report, as of December 31, 2003, the CAPCOs had invested approximately $89 million. As of that date, the CAPCOs valued their qualified investments at $24.3 million. The auditor estimated that economic activity and the jobs generated by the program would not produce sufficient revenue to offset the cost of the insurance tax credits.

NEW YORK CAPCO

From 1997 to 2005, New York funded five rounds of CAPCO credits totaling $400 million. The New York Department of Insurance reported that, as of the December 2010, $324.6 million, 81 percent of the total $400 million certified capital, had been invested in 84 portfolio companies.

FLORIDA CAPCO

In 1998, the Florida legislature authorized $150 million in CAPCOs insurance tax credits to be taken $15 million each year for 10 years. According to a report in Economic Development Quarterly, only three of 15 CAPCOs certified by the state were able to secure the level of commitments necessary to participate in the program. The Florida CAPCO program was repealed effective December 31, 2010.

WISCONSIN CAPCO

Legislation establishing the Wisconsin CAPCO program was passed in 1997 and implemented in 1999, when $50 million in tax credits were distributed among three CAPCOs. The credits were limited to 10 percent per year for 10 years. CAPCOs were allowed to distribute profits to its partners after 10 years even if investments had not reached 100 percent of certified capital.

COLORADO CAPCO

The Colorado program was implemented in 2002. The state made $200 million in premium tax credits available. The first $100 million was issued in April 2002, to be taken $10 million per year for 10 years. The second $100 million was scheduled to be allocated in April 2004.

The Colorado State Auditor issued a report on the state's CAPCO program in 2003. The report stated that research indicated that CAPCO programs are the most inefficient means for a state to raise venture capital. The auditor found that of the original $100 million in premium tax credits, approximately $44.4 million was available to invest in Colorado businesses. The remaining 55.6 percent had been used by CAPCOs to guarantee repayment of insurance companies' investments and to pay for start-up and other related costs.

After the audit, the Legislature diverted the scheduled second round of credits, using $50 million of the tax credits for state health insurance and the other $50 million to fund a new venture capital program. The new program is managed by a quasi-public authority that invests in private venture funds. The program is designed to provide an ongoing source of venture by requiring the investment firms to distribute 100 percent of certified capital to the state before final distribution to the venture capital fund operators.

DISTRICT OF COLUMBIA CAPCO

The District of Columbia implemented a CAPCO program in 2003 granting $50 million in credits beginning in 2009 and capped at $12.5 million each year. Three CAPCOs are participating in the D.C. program. As of April 2009, CAPCOs had invested $22 million in portfolio companies. In 2010, the D.C. statute was amended to change the way investments were counted toward CAPCO investment targets. Under the new law, each $1 of investment counts from $.50 to $1.25, depending on the type of industry in which the investment is made.

ALABAMA CAPCO

Alabama passed CAPCO legislation in 2003 and 2007. Each program granted $100 million in dollar-for-dollar insurance tax credit for investment in CAPCOs. The credits for the first program could be taken at the rate of 12.5 percent annually beginning with tax year 2006. Credits for the second round were limited to 5 percent per year for tax years 2010 through 2013 and 17.5 percent annually thereafter. As of December

31, 2010, Alabama CAPCOs had made $103.5 million in investments in portfolio companies.

TENNESSEE CAPCO

The Tennessee Small Business Investment Company Credit Act was implemented in 2009. In its initial enactment, the legislature authorized $120 million in insurance tax credits in exchange for insurance company investments in Tennessee venture firms called TNInvestcos. In 2010, another $80 million in credits was authorized. Insurance companies receive $20 million in credits for each $14 million in investments. The TNInvestcos invest in portfolio companies. Other spending from certified capital is restricted to qualified disbursements. These include formation costs, management fees, professional service, and taxes. Payments to investors are not qualified disbursements. The state receives 50 percent of the non-qualified distributions.

MARYLAND CAPCO/VENTURE CAPITAL HYBRID

In the Maryland plan called Invest Maryland, which is a hybrid of CAPCO and venture capital models, insurance companies bid for $100 million tax credits at a discounted rate. The minimum bid was 70 percent of the amount of credit sought. The credits were to be taken 20 percent each year. Sixty-seven percent of the proceeds of the auction were directed to private venture capital firms. The remaining 33 percent went to the existing Maryland Venture Fund. Maryland established an independent entity, the Maryland Venture Fund Authority, to distribute the funds to the private venture capital firms. The private venture firms, in turn, will invest in portfolio companies. In the Maryland plan, venture capital firms would return 100 percent of principal and 80 percent of profits to the state. The auction raised $84 million. The auction format succeeded in making a higher percentage of certified capital available for investment in portfolio companies than a CAPCO program.

RESTRUCTURE ANY FUTURE ROUNDS OF THE CAPCO PROGRAM

As described above and experienced by several other states, the structure and design of Texas' CAPCO program is inefficient in supporting venture capital activity within the state. A significant portion of program revenue is used for purposes other than investment in portfolio companies. The state, the principal source of revenue for the program, receives no direct benefit from the program. As a result, the program does not provide an ongoing source of venture capital in the state. If the Texas Legislature were to authorize a third CAPCO program, Recommendation 1 would amend the Texas Insurance Code, Chapter 228, with one or a number of several options to improve any future CAPCO programs.

OPTION 1: MODIFY THE CAPCO PROGRAM WITHIN THE EXISTING STRUCTURE

Option 1 would amend Texas Insurance Code, Chapter 228, to modify the CAPCO program while maintaining its basic structure. The primary change under Option 1 would be to require each CAPCO to invest an amount equal to 150 percent of certified capital before distribution to its owners. In addition, Option 1 would amend statute to include the following technical changes:

- incorporate the CPA rule requiring CAPCOs have at least 50 percent of their certified capital available for investment in portfolio companies;
- include in statute the CPA rule requiring loan agreements between CAPCOs and portfolio companies to have a term of at least two years;
- require CPA to review any investment in which a CAPCO investment is used to pay off an earlier CAPCO investment to determine if the investment should count toward investment targets; and
- giving CPA authority to audit CAPCOs.

OPTION 2: MODIFY THE CAPCO PROGRAM BY OFFERING A DISCOUNT FOR PREMIUM CREDITS

Option 2 would amend Texas Insurance Code, Chapter 228, to allow insurance companies more than one dollar of credit for each dollar invested in a CAPCO. For example, the state could allow $100 in deferred tax credits for each $70 of investment in CAPCOs, as was done in Tennessee. Under this option, insurance companies would continue to invest in CAPCOs through the current process. However, CAPCOs would be prohibited from distributing any money to insurance companies. The insurance company gains would come strictly from the discounted price of the credits. The need for CAPCOs to set aside a portion of certified capital to repay insurance companies would be eliminated. The purchase of third-party insurance to guarantee insurance company tax credits would continue to be an allowable expense. This structure would make a higher percentage of certified capital to be available for investment in portfolio companies.

OPTION 3: FUNDAMENTAL RESTRUCTURING

Option 3 would amend the Texas Insurance Code, Chapter 228, to fundamentally restructure the program. Under this option, rather than negotiate agreements with CAPCOs, insurance companies would bid on insurance tax credits. The bidding would be conducted by CPA through the Texas Safekeeping Trust Company. Proceeds of the auction would be deposited to the trust. CPA, with the advice of the Comptroller's Investment Advisory Board, would distribute proceeds of the auction to qualifying CAPCOs. CAPCOs would invest in portfolio companies within the guidelines of the current program. In this option, the insurance companies would purchase credits at a discount. This would eliminate the need for CAPCOs to set aside funds to repay their insurance company investors. It would also eliminate the need for CAPCOs to purchase re-insurance to guarantee insurance company investments. CAPCOs would retain their independence to select investments in portfolio companies.

OPTION 4: ALLOW THE TEXAS EMPLOYEE RETIREMENT SYSTEM TO PARTICIPATE IN CAPCO

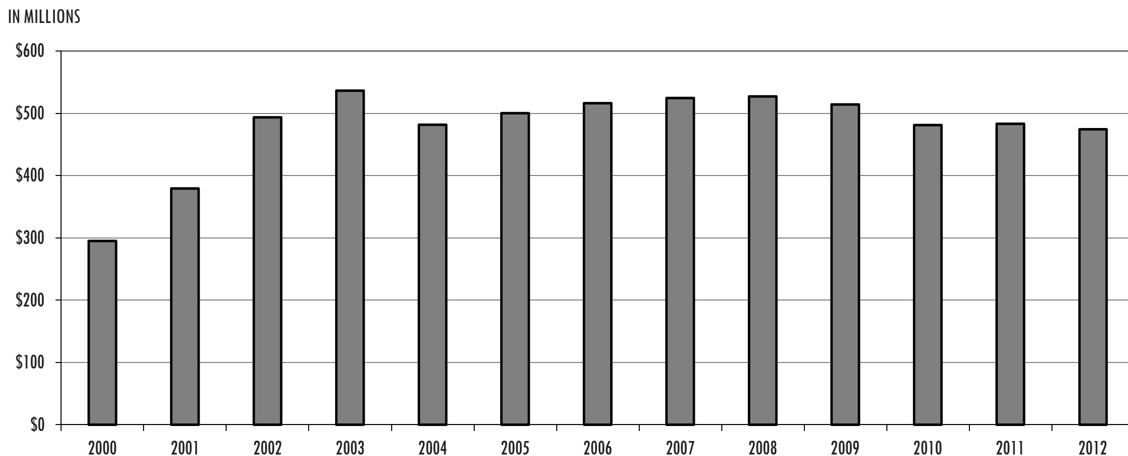
Texas and 45 other states receive revenue as a result of a 1998 master settlement with tobacco companies. A portion of the settlement includes perpetual payments from the tobacco companies. Texas has received in excess of $400 million from the perpetual payment each year since fiscal year 2001 as shown in **Figure 10**. At least nine states have chosen to securitize all or a portion of their settlement receipts. Securitization refers to replacing cash flows with negotiable securities.

Option 4 would amend the Texas Insurance Code, Chapter 228, to allow the Texas Employee Retirement System (ERS) to invest in the CAPCO program. ERS would be allowed to participate in any auction, such as in Option 3. Alternatively, ERS could be allowed to purchase a revenue stream outright at a discount. ERS would not bid for or purchase insurance tax credits, but would bid for or purchase a portion of the state's annual tobacco settlement payment that had been securitized. The combined amount of insurance tax credits and tobacco settlement payments available to fund CAPCOs would be limited. For example, if the Texas Legislature chooses to raise $200 million for investment in CAPCOs, the combined amount of insurance tax credits and securitized tobacco settlement revenue that would be available would be $200 million. Any amount of tobacco settlement revenue purchased by ERS would reduce the amount of insurance tax credits available to insurance companies. ERS could receive a return somewhat higher than its average return on fixed income investments. The gains for ERS would ultimately result in savings to the state by reducing the unfunded liability of ERS.

OPTION 5: CHANGE THE DISTRIBUTION

Under Program I and Program II, after a CAPCO meets its investment targets, the CAPCO can distribute all its funds to the CAPCO owners. The state receives no direct return. The distribution could be changed to provide the state an ongoing

FIGURE 10
TOBACCO SETTLEMENT REVENUE, FISCAL YEARS 2000 TO 2012



SOURCE: Comptroller of Public Accounts.

source of revenue to fund future venture capital programs. Any of the following distribution changes could be adopted in conjunction with any of the options described above:

- require each CAPCO to distribute to the state an amount equal to its certified capital plus an adjustment for inflation;
- require each CAPCO to distribute 50 percent of non-qualified distributions to the state; or
- require each CAPCO to distribute 100 percent of certified capital and 80 percent of profits to the state.

FISCAL IMPACT OF THE RECOMMENDATION

The options described would have no fiscal impact unless a third round of CAPCO is implemented.

If a third round of CAPCO were implemented, Options 1, 2, and 3 would have no direct fiscal impact on the state. Option 4 could result in a savings to the state by reducing the unfunded liability of ERS. Options 5 could provide the state with additional revenue that could be used to fund future venture capital investments or returned to the General Revenue Fund.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of this recommendation.

CREATE TAX PARITY FOR CONSUMERS OF CUSTOM COMPUTER SOFTWARE PROGRAMMING SERVICES

The Texas Tax Code is inconsistent regarding the taxation of custom computer programming services. In Texas, modifying off-the-shelf, or canned, software is taxable if the provider making the modification also sells software. Modifications by a provider who does not sell software are excluded from taxation. This exclusion creates an inequity in that it taxes the same service differently depending on the provider. By amending the Texas Tax Code to eliminate this exclusion, Texas would realize a gain of approximately $331.1 million in General Revenue Funds during the 2014–15 biennium. Local entities imposing sales tax would also realize a gain of approximately $87.9 million in Local Funds.

FACTS AND FINDINGS

- ♦ In Texas, computer software, whether delivered by physical media or by download, is treated as tangible personal property and is subject to the state's sales tax, as are computer-related services.
- ♦ The development of custom software is taxable in 12 states. Modifying canned computer software is taxable in 35 states.
- ♦ Texas is the only state that taxes the modification of canned software depending on the provider
- ♦ According to the Comptroller of Public Accounts, under the current tax policy for custom computer programming services the state will forgo approximately $360.4 million during the 2014–15 biennium.

CONCERN

- ♦ The Texas Tax Code's sales tax exclusion for the repair, maintenance, development, and restoration of software not sold by whoever provides the service creates an inequity in that it taxes the same service differently, depending on the provider.

RECOMMENDATION

- ♦ **Recommendation 1:** Amend statute to remove the sales tax exclusion for the repair, maintenance, creation and restoration of software not sold by the entity performing the service.

DISCUSSION

Custom computer programming services comprise two activities, the custom creation, or development, of software and the customization of pre-written, or published, software.

Developing custom software for a client is exempt from sales tax provided the new software does not use any preexisting programming code and the customer retains exclusive ownership rights to the new program or application.

Modifying published, or canned, software is taxable if the service provider also sells software. However, if a provider that does not sell software modifies canned software, the service is excluded from tax. The effect of this exclusion is that the state taxes the same service differently, depending on the provider.

In Texas, software, whether delivered by physical media or by download, is considered tangible personal property. Repairing, remodeling, maintaining, and restoring tangible personal property are generally taxable services. The Tax Code excludes from sales tax the repair, remodeling, maintenance, and restoration of aircraft; certain ships and boats; and the repair, maintenance, and restoration of motor vehicles, regardless of who provides the service. **Figure 1** illustrates the inconsistency in the sales tax treatment of customized tangible personal property.

Computer-related services are also taxable in Texas. Some examples of the state's current sales tax policies related to computer-related software services include:

- Services related to the setup of computers and information technology systems (including physically connecting components) are subject to sales tax.
- Configuring computer hardware and routers are taxable.
- Developing websites is taxable as a data processing service, although it is eligible for a 20 percent tax exemption.

COMPUTER-RELATED SERVICES IN OTHER STATES

All states that have a sales tax apply it to packaged, or canned, computer software. The majority of these states also tax the digital delivery of canned software. According to the 2012 Commerce Clearing House *State Tax Handbook*, the creation

FIGURE 1
TAXATION OF THE REPAIR, REMODELING, MAINTENANCE, AND RESTORATION OF TANGIBLE PERSONAL PROPERTY

	SERVICES BY A THIRD PARTY CONTRACTOR	SERVICES BY A RETAILER
Most Tangible Personal Property	Taxable	Taxable
Aircraft, Certain Ships, and Motor Vehicles	Excluded from Tax	Excluded from Tax
Published Computer Software	Excluded from Tax	Taxable

SOURCE: Legislative Budget Board.

of custom software is taxable in 12 states. Some of these states exempt particular industries or uses for custom software from the sales tax.

Modifying canned computer software is taxable in 35 states, although Connecticut taxes it at a lower rate. It is common for states to exempt the service under some circumstances, such as when it is for the exclusive use of a certain customer or if the modification is separately stated on the invoice. The *State Tax Handbook* does not indicate any other state having Texas' exclusion for one type of service provider while taxing another.

COMPUTER-RELATED SERVICES IN TEXAS

In 1984, the Sixty-eighth Legislature, Second Called Session, passed legislation to finance public education improvements and highway construction. The legislation taxed the sale of pre-programmed (or canned) computer software but excluded computer programming that was specially developed or that was a customized version of a canned product.

During the Seventieth Texas Legislature, Second Called Session, 1987, an omnibus tax bill repealed the exclusion for custom computer software.

Legislation passed by the Seventy-first Legislature, Regular Session, 1989, excluded from the sales tax any computer software creation, customization, maintenance, or repair that is performed by a service provider other then the software's original seller, though these third-party technicians were already exempt by rule.

CREATING PARITY FOR CONSUMERS OF CUSTOM PROGRAMMING SERVICES

Under current law, consumers who seek these services from a software retailer are subject to sales tax while consumers who seek the services from a third-party contractor are not. Recommendation 1 would remove the sales tax exclusion for the repair, maintenance, creation, or restoration of computer software not sold by the entity performing the service.

During the Eighty-first Legislature's Regular Session, proposed legislation would have repealed the custom computer programming services sales tax exclusion, which would have resulted in a gain of approximately $290 million to the General Revenue Fund for the 2012–13 biennium. The Tax Equity Note prepared by the Legislative Budget Board staff indicated that the change would affect businesses in the manufacturing, wholesale and retail trade, and mining industries. The note estimated their respective increases in initial tax liability to be 0.97 percent, 0.45 percent, and 0.42 percent. The estimate showed no initial effect on the household tax liability.

The Comptroller of Public Accounts tracks the estimated value of this exclusion in its biannual *Tax Exemptions and Tax Incidence Report*. This report refers to "contract computer programming," which comprises both the custom creation of software and the customization of pre-written software. **Figure 2** shows the most recent six-year estimate of the value of the exemption.

FIGURE 2
SIX-YEAR ESTIMATE OF THE VALUE OF THE SALES TAX EXCLUSION FOR COMPUTER SOFTWARE CUSTOMIZATION

FISCAL YEAR	ESTIMATED VALUE (IN MILLIONS)
2011	$150.8
2012	$158.2
2013	$166.6
2014	$175.6
2015	$184.8
2016	$194.0

SOURCE: Comptroller of Public Accounts.

FISCAL IMPACT OF THE RECOMMENDATION

Figure 3 shows that by eliminating this exclusion the state would realize a gain of approximately $331.1 million in General Revenue Funds during the 2014–15 biennium.

Local entities imposing a sales tax would also realize a gain of approximately $87.9 million in Local Funds. The estimate assumes an effective date of October 1, 2013.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of this recommendation.

FIGURE 3
FIVE-YEAR FISCAL IMPACT, FISCAL YEARS 2014 TO 2018

FISCAL YEAR	REVENUE GAIN IN GENERAL REVENUE FUNDS	REVENUE GAIN TO CITIES LOCAL FUNDS	GAIN TO TRANSIT AUTHORITIES IN LOCAL FUNDS	GAIN TO COUNTIES IN LOCAL FUNDS
2014	$146,333,333	$24,493,234	$8,470,750	$3,460,888
2015	$184,800,000	$34,716,800	$11,886,898	$4,855,974
2016	$194,000,000	$36,079,571	$12,478,400	$5,098,893
2017	$203,200,000	$42,812,872	$14,806,857	$6,050,329
2018	$212,800,000	$39,576,488	$13,686,743	$5,591,894

Source: Legislative Budget Board.

CLARIFY HOTEL TAX STATUTES TO PREVENT FUTURE REVENUE LOSSES

The state is engaged in a dispute with online travel companies such as Expedia, Orbitz, and Hotels.com over how the state hotel tax should be calculated. Online travel companies contract with hotels to book rooms on behalf of the hotel. The online travel companies pay hotels a discounted price for rooms and then book rooms to consumers at a marked-up price. This practice creates two prices: the price the online travel company pays the hotel, and the price the customer pays the online travel company. The state's dispute with the companies is over which of these prices is the taxable price.

State statute imposes the tax on the amount paid by the occupant for the right to occupy a room. The Comptroller of Public Accounts has ruled that the tax must be calculated on the price the customer pays the online travel company. Online travel companies contend that the tax should be collected on the discounted price they pay the hotel. The online travel companies are challenging the Comptroller of Public Accounts' ruling through the hearings process at the State Office of Administrative Hearings. While the dispute is under administrative review, the online travel companies are not collecting tax on their mark-up. As a result, collections for the state hotel occupancy tax are reduced by $11 million to $15 million annually. A similar issue affects hotel taxes levied by Texas cities and counties. A number of lawsuits have been filed nationwide claiming that online travel companies are in violation of local hotel occupancy tax ordinances. Three cases involving Texas cities have been adjudicated as of September 2012.

The outcome of local hotel tax litigation has often depended on the specific wording of the local laws imposing the tax. Likewise, the outcome of future litigation about the state hotel tax may depend on the specific language of state law. Clarifying the state hotel occupancy tax statute would not affect taxes imposed under current law, but could prevent prospective revenue losses in the event of an unfavorable outcome of litigation.

CONCERNS

- The method used by online travel companies to compute the state hotel tax costs the state between $11 million and $15 million each year. Local governments also lose between $15 million and $19 million each year due to this methodology.
- The state hotel occupancy tax statute does not explicitly address which party in an online hotel booking is responsible for remitting tax to the state.
- The state hotel occupancy tax statute does not address the tax treatment of online travel company mark- ups on bundled travel arrangements.

RECOMMENDATIONS

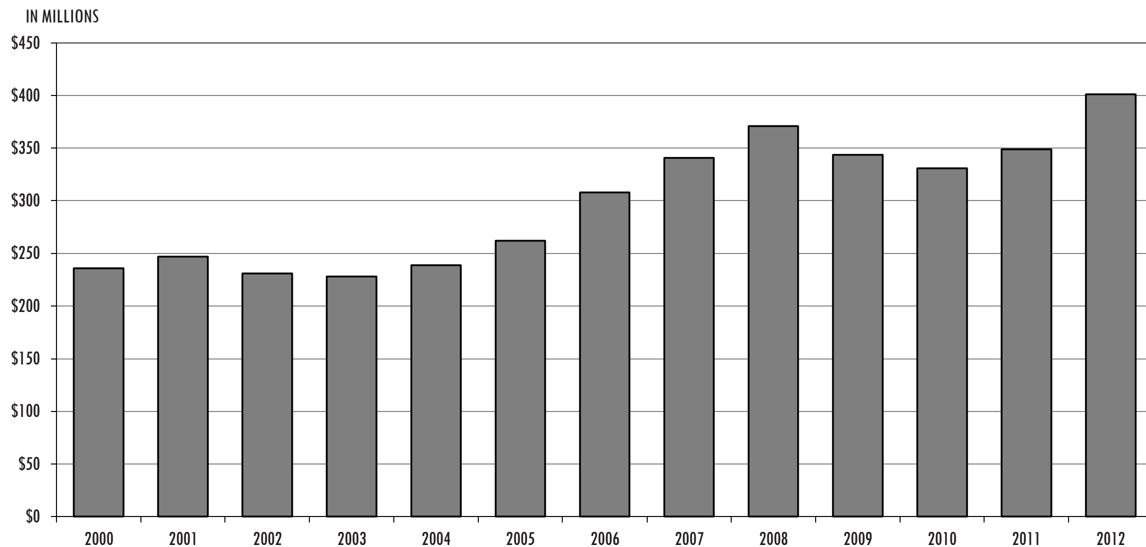
- **Recommendation 1:** Amend statute to explicitly include online travel company mark-ups in the price of the room subject to the hotel tax.
- **Recommendation 2:** Amend statute to specify which parties in an online booking transaction are responsible for remitting the hotel tax.
- **Recommendation 3:** Amend statute to address the hotel tax liability for online travel company mark-ups on bundled travel services.
- **Recommendation 4:** Amend statute to conform the state statute authorizing local hotel taxes to changes in the state hotel occupancy statute.

DISCUSSION

The Texas Tax Code, Chapter 156, imposes a hotel occupancy tax on the occupant of the room, not the hotel. The rate of tax is 6 percent of the price paid by the occupant for the right to occupy a room. The tax does not apply to rooms costing less than $15 per day or to permanent residents. A permanent resident is defined as a person who has the right to occupy a hotel room for at least 30 consecutive days. The price of a hotel room does not include the cost of food served by the hotel or personal services performed by the hotel for the person except for room preparation. A person owning, operating, managing, or controlling a hotel collects the tax on behalf of the state.

The state received $408.3 million in hotel taxes in fiscal year 2012. The Comptroller of Public Accounts (CPA) estimates the state will collect $747.7 million in hotel taxes during the 2012–13 biennium. **Figure 1** shows state hotel tax collections for fiscal years 2000 to 2012.

FIGURE 1
TEXAS STATE HOTEL TAX COLLECTIONS
FISCAL YEARS 2000 TO 2012



Source: Comptroller of Public Accounts.

Texas law also authorizes cities and counties to impose local hotel occupancy taxes. Municipal hotel taxes are authorized in the Texas Tax Code, Chapter 351. County hotel taxes are authorized in the Texas Tax Code, Chapter 352. The local taxes are levied through local ordinances for cities, and orders or resolutions for counties. The details of these local laws and local tax rates vary across the state. The taxes are administered and collected by local governments. Most cities can levy a tax of 7 percent, but some cities can impose a tax of up to 9 percent. City taxes must be used to promote tourism and the convention and hotel industry.

County rates authorized by state law range from 2 percent to 7 percent. State law prohibits some counties from taxing hotels within city limits.

With voter approval, some jurisdictions may levy special venue taxes not to exceed 2 percent. Dallas County is the exception; it can impose a venue tax of 3 percent. A recent study sponsored by the Office of the Governor estimated that local hotel taxes in Texas totaled $570 million in 2011. Both state and local hotel tax collections are negatively impacted by online travel companies' (OTCs) tax practices relating to the calculation of the hotel tax. The state loses between $11 million and $15 million annually. Local jurisdictions lose between $13 million and $19 million each year.

MERCHANT MODEL AND TAX BASE

OTCs operate primarily under the merchant model. Under this model, OTCs enter into agreements with hotels to book rooms on their behalf. The hotels charge OTCs discounted room prices, typically 15 percent to 25 percent below retail. The OTCs then book rooms to customers at a marked-up price. The OTCs set the retail price of the room charged to the consumer and are the merchant of record. The merchant model creates two prices. The first price is the discounted or wholesale price the OTCs pay the hotels. The second is the marked up or retail price the customers pay to the OTC. Under the merchant model, there is a dispute between the state and the OTCs over which price is the taxable price.

In contrast to the merchant model, booking through traditional travel agents does not cause a tax issue. Traditional travel agents operate under the agency model. Under this model, the travel agent books a hotel reservation on behalf of the consumer. The hotel charges the guest when the guest checks out. This charge includes taxes on the retail price paid by the customer. The hotel pays the agent a commission. The state and local taxing entities receive the tax on the full retail price paid by the occupant of hotel room. In the agency model, the hotel sets the retail price of the room and is the merchant of record.

Figure 2 shows the difference in tax treatment between a hypothetical booking directly through the hotel and a hypothetical booking through an OTC using the merchant model.

FIGURE 2
COMPARISON OF A HYPOTHETICAL BOOKING THROUGH A HOTEL TO HYPOTHETICAL BOOKING THROUGH AN ONLINE TRAVEL COMPANY, 2012

Booking Directly with Hotel	
Price Paid by Consumer	$150.00
State Tax Rate 6 percent and Local Hotel Tax Rate 7 percent	13%
State Hotel Tax	$19.50
Total Amount by Paid Consumer Including Tax	$169.50
Amount the Hotel Keeps	$150.00
State and Local Taxes	$19.50
State Taxes	**$9.00**
Local Taxes	**$10.50**
Using OTC	
Total Amount by Paid Consumer Including Tax	$169.50
OTC Discount Percentage	20%
OTC Discount	$33.90
Amount the OTC Sends the Hotel	$135.60
Hotel Retains	$120.00
State Tax Rate 6 percent and Local Hotel Tax Rate 7 percent	13%
State and Local Taxes	$15.60
State and Local Governments Lose	$3.90
State Loses	$1.80
Local Government Loses	$2.10

Source: Legislative Budget Board.

In a series of letter rulings beginning in 2002, CPA ruled that the hotel tax is due on the price the customer pays to the OTC. CPA recently audited seven OTCs and found they are not conforming to CPA rulings. OTCs continue to send taxes to the hotel based on the discounted price they pay for the rooms. The hotels then remit the tax on the discounted price to the state. The OTCs are challenging the CPA's rulings through the administrative hearings process at the Office of State Administrative Hearings. The date of the hearing has not been set. During the hearings process, the OTCs continue to collect the tax only on the price they pay the hotels rather than the price the customer pays the OTC. The method online travel companies use to calculate hotel occupancy tax reduces state hotel tax collections by $11 million to $15 million annually.

Recommendation 1 would amend the Texas Tax Code, Section 156.051, to explicitly include OTC mark-ups in the tax base. This amendment would be a clarification, not a substantive change. This change would protect the state from future revenue losses if courts rule against the state in litigation based on current statute. Minnesota, North Carolina, and the District of Columbia have amended their hotel tax statutes to specifically tax the retail room rate charged by the OTCs. The State of New York has amended its law to ensure that state and local taxes apply to the OTC mark-up.

REMITTING THE TAX

The Texas state hotel tax statute requires a person owning, operating, managing, or controlling a hotel to collect the hotel occupancy tax. While statute does not specify which party is responsible for remitting tax in an online transaction, CPA letter rulings have addressed this issue. CPA has consistently held that the hotel and the OTC each are responsible for remitting part of the tax. The hotel must remit the tax paid on the amount the OTC pays to the hotel. The OTC must remit the tax on its mark-up.

The Multistate Tax Commission (MTC) is an intergovernmental organization that promotes uniformity and compatibility in tax systems. Texas is a member state. The MTC has drafted model statutes with two options to address this issue. In the first, the OTC collects tax on the full cost of the room from the customer. The OTC then forwards the tax to the hotel, and the hotel remits the tax to the taxing entity. The second option is a dual track method. The OTC collects tax on 100 percent of the retail price it charges to its customers. The OTC remits the tax due on its mark-up directly to the taxing agency. It then forwards the tax due on the discounted price to the hotel. The hotel, in turn, remits it to the taxing agency. Recommendation 2 would amend the Texas Tax Code, Section 156.053, to explicitly state that OTCs are responsible for collecting and remitting the tax on their mark-up. Hotels would continue to remit taxes on the price paid by the OTC to the hotel. The provision would provide that a hotel is not responsible for the tax on the OTC mark-up if the OTC fails to remit the tax. The statute would be consistent with both the CPA's current policy and the dual track MTC option.

BUNDLED TRAVEL ARRANGEMENTS

Many OTCs make bundled travel arrangements that include a combination of hotel, rental car, and airline reservations. The combined pricing makes it difficult to determine how much of the markup is attributable to the hotel booking. According to the Texas Administrative Code, the total charge for bundled travel arrangements is subject to the occupancy tax unless the room charge is stated separately. If the room charge is stated separately only the room charge is subject to tax. Recommendation 3 would amend the Texas Tax Code, Chapter 156, to address the tax treatment of OTC mark-ups in bundled travel arrangements. The amendment would require the OTC to apportion its mark-up in a bundled transaction from the OTCs books and records by reasonable and verifiable standards. The amendment would authorize CPA to determine what constitutes a reasonable and verifiable computation of a separate room charge.

LEGAL ACTION

A number of lawsuits have been filed recently by cities and counties claiming that OTCs are in violation of their hotel occupancy tax ordinances. As of May 2012, 70 lawsuits had been filed in 25 states and the District of Columbia. As of that date, OTCs had won in 18 of the 25 states. Governments won in three states and the District of Columbia.

In some litigation, OTCs have argued that the Commerce Clause of the U.S. Constitution protects them from having to collect tax on behalf of states in which they have no physical presence or nexus. The OTCs have not typically prevailed on this issue. A South Carolina court ruled hotels are agents of the OTCs and provide physical presence. One factor weakening OTC's nexus argument is that OTCs collect taxes on the wholesale price of bookings. A Georgia court found the OTC becomes accountable for collecting local taxes by contracting with hotels to collect the tax.

Most cases, including recent cases involving Texas cities, have focused on the definition of the tax base. In *City of Houston v. Hotels.Com, L.P.*, the Texas Court of Appeals, Fourteenth District, Houston, ruled in favor of the OTCs. The City of Houston ordinance in question read as follows:

> "There is hereby levied within the corporate limits of the city a tax upon the cost of occupancy of any room furnished by any hotel where such cost of occupancy is at the rate of $2.00 or more per day, such tax to be equal to seven percent of the consideration paid by the occupant of such room to such hotel."

The court held that hotel occupancy taxes imposed by local taxing authorities applied to the discounted room rates that hotels charged OTCs. The court ruled that consumer payments to the OTCs include compensation for services and benefits in addition to the cost of the room. Visitors to the OTC website could access maps, check room availability, and compare rates, ratings, and the reviews of other hotels. The court also ruled:

> "This court must resolve any ambiguity in a tax statute in favor of the taxpayer… We do not consider whether Houston's interpretation is reasonable. If Houston's interpretation of the ordinance is also reasonable, then the ordinance is ambiguous and the trial court could have properly granted summary judgment on the ground that the ordinance is ambiguous and therefore must be strictly construed against Houston and in the OTC's favor."

In *City of Orange v. Hotels.com*, a federal district court ruled in favor of the OTCs. Like the Houston ordinance, the wording of the Orange city ordinance levied the tax on the amount of consideration paid to the hotel.

In 2011, 173 cities won a class action suit against the OTCs in federal court. In *City of San Antonio v. Hotels.com*, a U.S. District Court ruled that OTCs must collect and remit taxes on the full retail price they charge consumers. The San Antonio ordinance is worded differently from the Houston and Orange ordinances. The San Antonio ordinance states,

> "There is hereby levied a tax upon the cost of or consideration paid for a sleeping room or sleeping facility furnished by any hotel. The tax shall be equal to nine (9) percent of the total price of a sleeping room or sleeping facility, said price to include all goods and services provided by the hotel which are not ordinarily subject to sales tax."

The judge in the San Antonio case found:

- OTCs exercise control of the taxable transaction;
- Only the OTCs know the total retail amount paid by the occupant;
- OTCs are not occupants of the hotel room;
- OTCs have a duty to collect tax on the total retail price charged the occupant.

The OTCs are appealing the ruling in the San Antonio case.

The current state statute authorizing local hotel taxes tracks the state hotel tax statute with respect to whom the tax is imposed on. Recommendation 4 would amend the Texas Tax Code to conform the state law authorizing local hotel

occupancy taxes to the proposed changes in state hotel tax law. Changing the state statute authorizing the local tax would not guarantee that local governments would collect taxes on the retail price of rooms. The change in the state law authorizing local hotel taxes could protect local taxing authorities from prospective losses if courts rule against the state in cases adjudicating current state statutes. However, the ability of local governments to collect hotel taxes from OTCs depends primarily on the specific wording of local laws. It would remain the responsibility of the local governing bodies to determine the wording of local hotel tax laws.

FEDERAL LEGISLATION

Federal legislation that would prohibit states from taxing OTC charges was introduced in the One Hundred Twelfth Congress. The latest major action occurred in December 2011 when the bill was referred to the Senate Committee on Finance.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendation 1, amending the state hotel tax to explicitly include OTC booking charges in the tax base, would have no fiscal impact compared to CPA's interpretation of current law. If the court interpretation of current law is unfavorable to the state, the change could protect the state against prospective annual revenue losses of between $11 million and $15 million.

Recommendation 2, amending the state hotel occupancy tax law to specify which parties are required to remit taxes, would have no fiscal impact.

Recommendation 3, specifying a method for calculating the hotel tax on bundled travel arrangements, could result in a revenue gain to the state. The amount of the gain cannot be determined.

Amending the state law authorizing local hotel taxes would have no fiscal impact on the state. Changing the state statute authorizing the local tax in accordance with Recommendation 4, would not guarantee that local governments would collect taxes on the retail price of hotel rooms, but could protect local taxing authorities from prospective annual losses of $15 million to $19 million if courts rule against the state in cases adjudicating current state statutes.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

MODIFY THE EVEN-EXCHANGE EXEMPTION TO THE MOTOR VEHICLE SALES TAX TO LIMIT THE RISK OF ABUSE

Texas statute allows a person who exchanges a vehicle for another to be exempt from paying the motor vehicle sales tax and instead pay a $5 even-exchange tax at the time of vehicle registration. Statute does not define "even-exchange" and, as a result, vehicles with significant value differences may be traded under this provision. Moreover, controls intended to ensure the validity of claims for the even-exchange exemption are insufficient and open the provision to fraud and abuse. Modifying statutory requirements pertaining to individuals claiming a vehicle as an even exchange would result in a gain of $8.5 million in the General Revenue Funds during the 2014–15 biennium.

FACTS AND FINDINGS

- Eligible parties receiving a vehicle as a gift are exempt from paying the motor vehicle sales tax of 6.25 percent; instead they pay a $10 gift tax. Following the passage of the law restricting who could claim a car as a gift, the number of motor vehicles claimed as even exchanges rose by 30.6 percent from fiscal years 2009 to 2010. Gift claims dropped by 57.8 percent during the same period.
- Seven of the ten most populous states do not provide an even exchange exemption and instead require full tax payment on the value of the vehicle received.
- Data obtained from the Comptroller of Public Accounts shows that of the 18,429 even-exchange transactions for fiscal year 2011 only 60 exchanges included vehicles whose values were equal.

CONCERNS

- Neither county tax assessors nor the Texas Comptroller of Public Accounts have sufficient data to verify compliance with statutory requirements pertaining to the even-exchange exemption to the motor vehicles sales tax. The lack of verification measures to ensure compliance with even exchange statutory requirements increases the risk of abuse and makes it difficult to detect.
- Since an "even exchange" is not defined in statute, a person can avoid paying taxes on a vehicle even when the value of the purchased vehicle far exceeds the value of the "even exchange." For example, a person claiming the even-exchange tax exemption can exchange a $4,000 vehicle for one that is valued at $10,000 and pay the $5 even-exchange tax. The state foregoes the sales tax owed on the $6,000 value difference of the vehicles, or $375 in motor vehicle sales tax revenue.

RECOMMENDATION

- **Recommendation 1:** Amend statute to define an even exchange as a transaction where the standard presumptive value or professional appraisals of the exchanged vehicles are within $80 of each other.

DISCUSSION

Texas assesses a motor vehicle sales tax of 6.25 percent on all vehicle purchases. In fiscal years 2010 and 2011, the motor vehicle sales tax generated approximately $3.0 billion in General Revenue Funds each fiscal year. The tax is applied to the greater of the sale price or at least 80 percent of the standard presumptive value (SPV), or the appraised value of the vehicle if the purchase price is less than 80 percent of the SPV. Statute allows for some exemptions and deductions to reduce the purchaser's sales tax liability, resulting in less revenue to the state.

The gift tax on motor vehicles is one such exemption. Before September 2009, any person who claimed to receive a vehicle as a gift was exempt from paying the motor vehicle sales tax, and instead incurred a $10 gift tax. There were no requirements that the person making the gift be related to the person claiming the gift tax or that the gifted vehicle be below a certain value. The only evidence needed to claim the vehicle was a gift was the signature of the person making the gift on the Application for Texas Certificate of Title (Form 130-U). Few safeguards were in place to ensure that claims of gifts were legitimate. Therefore, a buyer could have the seller of the vehicle sign the Form 130-U and then mark the transaction as a gift with or without the knowledge of the seller. In an effort to reduce abuse of this provision, the Eighty-first Legislature, Regular Session, 2009, passed legislation that amended the law limiting eligibility for the gift tax and requiring an affidavit signed by both parties of the transaction. The new law restricts who qualifies for a gift

exchange exemption to certain relatives and to estate transfers.

The number of motor vehicles claimed as gifts between September 2006 and August 2012 dropped significantly. Based on data from the Comptroller of Public Accounts (CPA), the number of vehicles claimed as gifts averaged approximately 430,000 per fiscal year until fiscal year 2010; at this point, the statutory requirements for the gift tax exemption were changed. Since then, the number of vehicles claimed as gifts has decreased to an average of approximately 202,000 per fiscal year.

EVEN-EXCHANGE TAX EXEMPTION

Statutory changes made by the Eighty-first Legislature, Regular Session, 2009, require more documentation and stricter regulations to qualify for the gift tax. As a result, buyers of vehicles may be more inclined to claim other exemptions to avoid paying the motor vehicle sales tax. The Texas Tax Code, Section 152.024, provides for a $5 tax on each party to a transaction involving the even exchange of two motor vehicles. The statutory provisions allow for two people to exchange vehicles and avoid the motor vehicle sales tax. Since an "even exchange" is not defined in statute, a person can avoid paying sales tax on a traded vehicle even if the value of the vehicle far exceeds the value of the "even exchange." County tax assessors are responsible for the enforcement and collection of the motor vehicle sales tax. According to county tax assessor staff, a person can trade a vehicle valued at $4,000 for one valued at $10,000 and pay only the $5 even-exchange tax. This is inconsistent with the law that provides that a person purchasing a vehicle must pay tax on the purchase price less the value of a trade-in. In this situation, a person would owe $375 ($10,000–$4,000=$6,000*.0625) in motor vehicles sales taxes; significantly more than the $5 even exchange tax.

The exemption is claimed at the time the sales tax is paid and the exchanged vehicle is titled and registered at the county tax assessor-collector's office. A person claiming this exemption must complete Form 130-U, which includes a description of the exchanged vehicles and their vehicle identification numbers (VIN). Signatures of both parties to the transaction are required. However, the Form 130-U is not an effective tool to verify whether the taxpayer is complying with the law. County tax assessor-collector's offices do not have sufficient resources to ensure that an exchange actually occurred, that the exchanged vehicle is legitimate (i.e., titled in the taxpayer's name), or that the second party to the transaction is aware of the even exchange claim. Without oversight of the transaction, a purchaser can buy a car from a seller, have the seller sign the form, and later note that the transaction was an even exchange with or without the knowledge of seller.

While illegal, it is more economical for a buyer to illegitimately claim the purchase of a vehicle as an even exchange if the purchased vehicle has a value of more than $80. **Figure 1** shows the sales tax on a motor vehicle with a standard presumptive value of $80 or more would be $5 or more.

FIGURE 1
POINT AT WHICH THE STANDARD PRESUMPTIVE VALUE OF A VEHICLE YIELDS A SALES TAX EQUIVALENT TO THE EVEN EXCHANGE TAX, 2012

Motor vehicle sales tax due on a vehicle worth $80 is:
sales tax rate * SPV = 6.25% * $80 = $5.

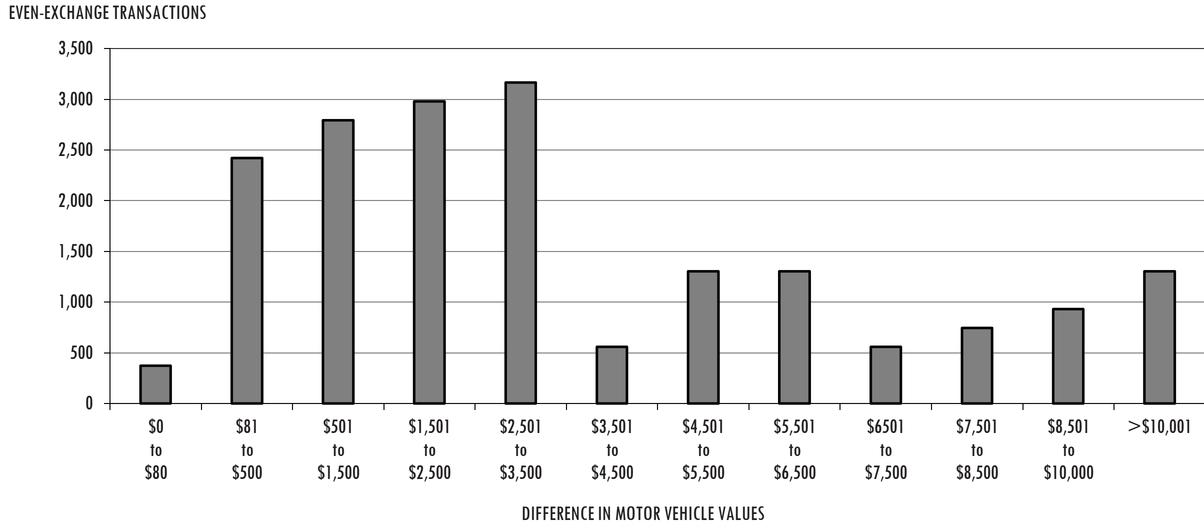
Source: Legislative Budget Board.

Figure 2 shows the number of all fiscal year 2011 even-exchange transactions that are within each range of differences in values of traded vehicles. Of the 18,429 even-exchange transactions (or 36,858 total cars registered as even exchanges), more than 3,000 pairs of vehicles had a difference in value that ranged from $2,501 to $3,500. The $2,501 to $3,500 range had the highest number of claims, which indicates the state lost between $156 and $219 in sales tax revenue for each transaction within that range. Data obtained from the CPA also shows that of the total number of even-exchange transactions for fiscal year 2011 only 60 exchanges included vehicles whose values were equal, while 1,303 pairs of vehicles had a difference in value of more than $10,000. Essentially, a person was able to trade their motor vehicle valued at $8,000 for one valued at $18,000. The data also shows 372 even-exchange transactions had a difference in vehicle values of $80 or less. The monetary benefit of paying less sales tax coupled with the ease in claiming a motor vehicle as an even exchange on Form 130-U may incentivize people to falsely identify vehicles as even exchanges.

In fiscal year 2010, the year eligibility for the gift tax exemption was restricted, the number of transactions claimed as gifts dropped by 57.8 percent to 199,538 while claims for even exchanges increased in this same period by 30.6 percent to 31,476 as shown in **Figure 3**.

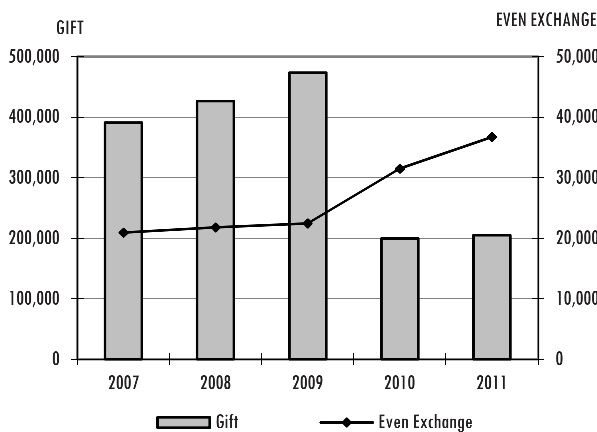
Absent an audit of each even exchange transaction, CPA does not have the information necessary to validate each claim of an even exchange or its compliance with statutory

FIGURE 2
NUMBER OF MOTOR VEHICLE EVEN-EXCHANGE TRANSACTIONS BY DIFFERENCE IN VALUE OF TRADED VEHICLES
FISCAL YEAR 2011



Source: Legislative Budget Board.

FIGURE 3
NUMBER OF MOTOR VEHICLES CLAIMED AS EVEN EXCHANGES OR GIFTS
FISCAL YEARS 2007 TO 2011



Source: Legislative Budget Board.

requirements. The lack of such validation measures increases the risk of abuse and makes it difficult to detect.

REDUCE THE RISK OF ABUSE OF THE EVEN-TRADE EXEMPTION

Illegitimate claims of even trades of motor vehicles results in a loss to the state's General Revenue Fund. While the even-exchange exemption to the motor vehicle sales tax is authorized in statute, there is a risk that it may be abused. Recommendation 1 would amend the Texas Tax Code, Section 152.024, defining an even exchange as a transaction where the standard presumptive value or professional appraisals of the exchanged vehicles are within $80 of each other. The party to the transaction who receives the vehicle with the highest value would be responsible for paying the motor vehicle sales tax on the difference in value of the vehicles.

Figure 4 shows common scenarios that could result under the proposed requirements for an even-exchange transaction. In Scenario A, the parties would not owe any sales tax since the vehicles in the transaction do not have a difference in value that exceeds $80. Instead each party would be responsible for paying the $5 even-exchange tax when titling their newly acquired vehicle; the same under current law. By applying the provisions of Recommendation 1 to fiscal year 2011 data, only 372 of the total even-exchange transactions would have qualified to pay the even exchange tax of $5.

Furthermore, person 2 in Scenario B would owe $18.75 since under this proposed recommendation the person who receives the higher valued vehicle is responsible for paying tax and the difference in value of the exchanged vehicles is greater than the $80 threshold. This transaction would result in additional state revenue that would have otherwise been forfeited under current statute. Had these provisions been in

FIGURE 4
SCENARIOS OF TAXES OWED UNDER PROPOSED EVEN-EXCHANGE REQUIREMENTS, FISCAL YEAR 2012

SCENARIO	SITUATION	TAX DUE
A	Person 1 receives Car B valued at $1,500 from Person 2	Person 1 owes the $5 even-exemption tax since the car received has the lesser value of the 2 vehicles.
	Person 2 receives Car A valued at $1,535 from Person 1	Person 2 owes the $5 even-exchange tax since the difference in value ($35) of the exchanged vehicles is less than $80.
B	Person 1 receives Car B valued at $1,500 from Person 2	Person 1 owes the $5 even-exchange tax since the car received has the lesser value of the 2 vehicles.
	Person 2 receives Car A valued at $1,800 from Person 2	Person 2 owes $18.75 in sales tax since the vehicle received has a higher value and the difference in value of the exchanged vehicles ($300) is greater than the $80 threshold.

Source: Legislative Budget Board.

place in fiscal year 2011, 98 percent of the even-trade transactions would have owed additional tax.

These changes would reduce the number of people illegitimately claiming vehicles as even exchanges and mitigate the subsequent loss in revenue. By defining what vehicles qualify for the exemption, local county tax assessors must verify the value of both vehicles traded. This new requirement will ensure the validity of the even exchange. Implementing this recommendation would help limit the abuse of the even-exchange claims and ensure that the state receives tax revenues that are due.

SALES TAX POLICIES ON EVEN EXCHANGES IN OTHER STATES

Like Texas, other states allow trade-in tax deductions, meaning that the motor vehicle sales tax is owed on the purchase price less the trade-in value of any vehicle offered. **Figure 5** shows the even-exchange exemptions of the 10 most populous states—Texas is the only state on the list without strict requirements. Five of these states do not offer a motor vehicle sales tax exemption for even exchanges, and instead require that taxes on the full value of the vehicles be paid.

Florida and Georgia allow the tax exemption but require additional documentation from claimants as proof that an even exchange has occurred. North Carolina requires both parties exchanging the vehicles be present when obtaining a new title to their vehicles. In North Carolina, the person with the higher valued vehicle, as determined by the state, will pay tax on the difference in values of the vehicles. These options may be strategies that some states use to improve controls and limit the loss of sales tax revenue to the state.

FIGURE 5
EVEN-EXCHANGE TAX LIABILITY FOR 10 MOST POPULOUS STATES
FISCAL YEAR 2012

STATE	TAX DUE	STATE SALES TAX RATE
California	Full Amount (no exemption)	8.25%
Texas	$5	6.25%
New York	Full Amount (no exemption)	4.00%
Florida	None, with sworn affidavit of the estimated value of trade	6.00%
Illinois	Full Amount (no exemption)	6.25%
Pennsylvania	Tax paid on difference in value of vehicles (no exemption)	6.00%
Ohio	Full amount (no exemption)	5.50%
Michigan	Full amount (no exemption)	6.00%
Georgia	None (additional form required)	4.00%
North Carolina	Tax paid on difference in value of vehicles (no exemption)	3.00%

Source: Legislative Budget Board.

FISCAL IMPACT OF DEFINING THE EVEN-EXCHANGE EXEMPTION TO THE MOTOR VEHICLE SALES TAX

By implementing Recommendation 1 to amend the even-exchange tax provision, the state would realize a gain of $8.5 million in General Revenue Funds during the 2014–15 biennium. This estimate is based on the average difference of the SPV of the vehicles claimed as even exchanges and the revenue realized if the exemption did not exist. A sample of the 36,858 vehicles that were claimed as even trades in fiscal year 2011 showed that the average difference in value per transaction was $3,762, or $235 in lost tax revenue per

transaction pursuant to current law. After holding the number of even-exchange claims flat for the 2014–15 biennium and adjusting for the loss in revenue from no longer taxing $5 for every even-trade registration, there would be a net gain of $4.2 million in General Revenue Funds for each fiscal year.

Figure 6 shows the fiscal impact of Recommendation 1. Subsequent fiscal years are expected to generate an increasing amount based on the average growth rate of even exchange claims of 3.6 percent before fiscal year 2009. Local governments would also realize a gain of $2.8 million in sales tax revenue for the biennium given their authority to levy a motor vehicle sales tax of 2 percent per vehicle.

FIGURE 6
FIVE-YEAR FISCAL IMPACT OF DEFINING THE EVEN-EXCHANGE EXEMPTION
FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE REVENUE GAIN/(LOSS) IN GENERAL REVENUE FUNDS	PROBABLE REVENUE GAIN/(LOSS) IN LOCAL REVENUE FUNDS
2014	$4,242,430	$1,386,468
2015	$4,242,430	$1,386,468
2016	$4,395,158	$1,436,381
2017	$4,553,383	$1,488,091
2018	$4,717,305	$1,541,662

Source: Legislative Budget Board.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of this recommendation.

IDENTIFY STATE COSTS RELATED TO DETERMINING CLIENT ELIGIBILITY FOR ENTITLEMENT PROGRAMS

The federal Affordable Care Act of 2010 requires that states provide the Centers for Medicare and Medicaid Services and future health insurance exchanges access to state eligibility systems. The state uses the Texas Integrated Eligibility Redesign System to determine eligibility and enroll clients in affected entitlement programs such as the Texas Medicaid program, the Supplemental Nutrition Assistance Program, and Temporary Assistance for Needy Families. The state plans to integrate the Children's Health Insurance Program eligibility system, currently operated by a contractor, with the Texas Integrated Eligibility Redesign System.

The Affordable Care Act authorized funding for enhanced Federal Financial Participation for a new Eligibility Modernization Program. The enhanced federal match is available to states from federal fiscal years 2012 to 2015. It will provide up to a 90 percent federal match for developing an eligibility determination system. The federal match rate for administrative costs related to these systems is 50 percent.

The Health and Human Services Commission estimates that by the end of December of 2013 the combined cost for Eligibility Modernization Program will be $148.2 million in All Funds ($110.3 million in Federal Funds and $38.0 million in General Revenue Funds). The integration of the Children's Health Insurance Program eligibility determination process with the state-operated system will generate an estimated cost savings of $54.8 million, which includes $39.0 million in Federal Funds and $15.8 million in General Revenue Funds for the 2014–15 biennium. In order to identify further fiscal impact to the state, the Health and Human Services Commission should be required to report any costs or cost savings to the Quality Assurance Team—the state entity responsible for oversight of technology projects.

CONCERN

- ♦ The Affordable Care Act's enhanced Federal Financial Participation for states to modernize eligibility systems will expire in fiscal year 2015. The end of enhanced match for modifications to the Texas Integrated Eligibility Redesign System will have a fiscal impact on the Health and Human Services Commission's budget in the 2016–17 biennium. Identifying these costs will provide the Legislature with the necessary information for anticipating spending demands before the 2016–17 biennium.

RECOMMENDATION

- ♦ **Recommendation 1:** Include a rider in the introduced 2014–15 General Appropriations Bill to direct the Health and Human Services Commission to include the fiscal impact of the federal Eligibility Modernization Program from fiscal years 2012 to 2015 in the Texas Project Delivery Framework, Project Monitoring Report to the state's Quality Assurance Team.

DISCUSSION

In December 2011, the Health and Human Services Commission (HHSC) converted and transferred the last Texas Medicaid program case files in the legacy eligibility system to the Texas Integrated Eligibility Redesign System (TIERS). The case file conversion and transfer completed a statewide technology initiative that started in the mid-1990s. According to HHSC, TIERS now uses web-based technology to make the eligibility determination process more efficient for several programs. TIERS determines eligibility of clients enrolling in entitlement programs, which include the Texas Medicaid program, the Supplemental Nutrition Assistance Program (SNAP), and Temporary Assistance for Needy Families (TANF). The state plans to integrate the determination process for the Children's Health Insurance Program (CHIP), which is now partially managed by a contractor, with TIERS in fiscal year 2013.

With the TIERS implementation complete, HHSC is planning to improve integration between systems that access and share eligibility information. In fiscal year 2012, HHSC completed planning and began implementation of its Client Portal Modernization Implementation project and Eligibility as a Service (EaaS) program. EaaS allows health and human service clients and providers to retrieve eligibility information as needed. Once implemented, EaaS will provide consistent eligibility information in real-time. Other functions will allow users to make the following inquiries:

- eligibility inquiries in the vendor drug system;
- provider inquiries through Medicaid Eligibility Health Information System; and

- provider and client inquiries through the electronic health record system.

Initial improvements implemented in fiscal year 2011 primarily allowed the system to accommodate Medicaid clients. This capability is already increasing user access. **Figure 1** shows trends from November 2011 to April 2012 in TIERS user access after improvements were implemented.

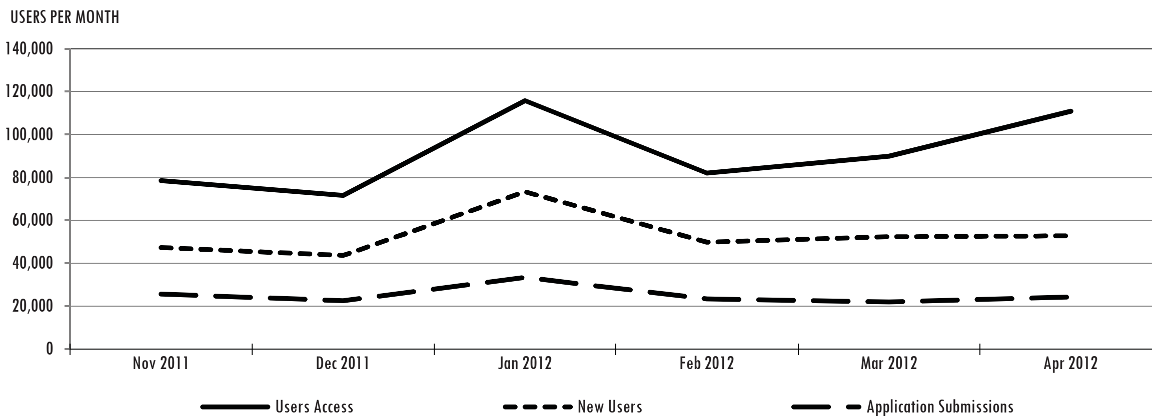
HHSC's Strategic Plan for fiscal years 2013 to 2017 states that increasing self-service functions are expected to improve business processes for both the clients and staff. Client Portal Modernization is the implementation of web-based technology to give clients the ability to apply for and access benefit information online. The improvements also allow clients to manage their case outside of regular office hours. Client self-service options also save staff time in processing and responding to clients about their cases. New system efficiencies reduce the amount of work overtime as caseloads increase. The agency's Strategic Plan details that clients can perform several functions on the HHSC eligibility website. **Figure 2** shows functions implemented in fiscal year 2012 and functions planned to be implemented in fiscal year 2013. Additional functions as a result of the Eligibility Modernization Program are expected to improve user access to TIERS further.

ELIGIBILITY MODERNIZATION PROGRAM

The Affordable Care Act of 2010 (ACA) requires states to streamline the Medicaid eligibility process. To assist states in meeting this requirement, enhanced federal match rates for state eligibility and enrollment systems modifications are available that were previously only applied to Medicaid Management Information Systems. The enhanced match was included in the ACA as part of the Eligibility Modernization Program. States with approved plans can modernize their eligibility systems and receive enhanced Federal Financial Participation (FFP) rates. The purpose of the program is for states to modernize their eligibility system to establish data sharing compatibility with other state, federal, and private Health Insurance Exchange (HIX) systems. Modernized state eligibility systems will interface with other entities to verify the Medicaid eligibility of low-income individuals who apply for insurance online. The ACA requires the establishment of HIXs, which the U.S. Department of Health and Human Services (HHS) describe as "competitive insurance marketplaces where individuals and small businesses can shop for health benefit plans." HIXs will help customers choose the most appropriate health plan. Federal HIXs will be available to residents in states that choose not to develop their own systems.

Another priority of the Eligibility Modernization Program is that states implement information technology that improves client and provider access to eligibility information. According to Center for Medicare and Medicaid Services (CMS) rules, state eligibility system modernization implementation plans must meet seven standards and conditions to maintain enhanced match levels. **Figure 3** shows the seven federal standards and the state compliance components.

FIGURE 1
MONTHLY ACCESS TREND FOR THE TEXAS INTEGRATED ELIGIBILITY REDESIGN SYSTEM
NOVEMBER 2011 TO APRIL 2012



SOURCE: Health and Human Services Commission.

FIGURE 2
TEXAS INTEGRATED ELIGIBILITY REDESIGN SYSTEM CLIENT FUNCTIONS BY YEAR OF IMPLEMENTATION
FISCAL YEARS 2012 AND 2013

FUNCTIONS IMPLEMENTED IN FISCAL YEAR 2012	FUNCTIONS PLANNED FOR FISCAL YEAR 2013
Prescreening to determine if they are eligible for benefits	Submitting re-determinations
Creating an account	Viewing correspondence online
Submitting a new application	Opting out of paper notifications to receive all communications electronically
Viewing case details	Uploading documents
Updating address/phone information	
Printing temporary Medicaid identification cards	
Reporting changes	

Source: Health and Human Services Commission.

FIGURE 3
FEDERAL ELIGIBILITY MODERNIZATION IMPLEMENTATION STANDARDS AND STATE COMPLIANCE COMPONENTS, FISCAL YEAR 2012

FEDERAL STANDARD	STATE COMPLIANCE REQUIREMENTS
Achieve Modularity	Build capabilities for self-service; electronic information submissions; coordinates systems workflow engine; build a rules engine; incorporate changes for case management; create updated document generation systems; and develop, install and manage electronic content management.
Integrate	Implement eligibility system changes in conjunction with any Medicaid Information Technology Administration system modifications to minimize duplication and ensure compatibility.
Meet Industry Standards	Comply with Health Insurance Portability and Accountability Act of 1996 (HIPAA) Privacy and Security Rules and the National Institutes of Standards and Technology Security Framework.
Leverage	Share technology with other states.
Business Results	Implement system applications for making self-service real-time determinations and implement a Data Mart codified system that can interface with other business applications.
Reporting	Provide real-time task monitoring and analytical reporting.
Interoperability	Maintain seamless coordination and integration with Exchange, as well as interoperability with other entities housing health and human services data.

Source: Health and Human Services Commission.

HHSC must submit and receive CMS approval for Advance Planning Documents (APD) through each phase of the state's eligibility modernization initiative. Enhanced FFP for Eligibility Modernization Program funding is available through December 2015. CMS guidance to states for the Eligibility Modernization Program shows that federal match for administration costs related to these systems will remain at 50/50, state/federal. New enhanced Medicaid match rates are applied in the following two major categories:

- design, development, and implementation (DDI) category—90/10, federal/state match; and
- operations and maintenance category—75/25, federal/state match.

If HHSC meets its December 2013 project implementation deadlines, the agency will be eligible to apply for an additional period of enhanced FFP for operations and maintenance. The U.S. Office of Management and Budget approved an additional waiver (Waiver 87). This waiver allows states to receive 90/10 (federal/state) match ratio or cost sharing with other entitlement programs that benefit from modifications to a state's eligibility system. The modifications may include other programs if they provide a common benefit to Medicaid. Enhanced match opportunities available through the waiver include the following federal programs:

- Supplemental Nutrition Assistance Program (SNAP)—work that benefits only SNAP will continue to receive the 50/50 federal/state match.

- Children's Health Insurance Program (CHIP)—work that benefits only CHIP will receive the CHIP Enhanced Federal Medicaid Assistance Percentages (EFMAP) rate.
- Temporary Assistance for Needy Families (TANF)—work that benefits only TANF will be funded entirely with TANF-related funds.

CHALLENGES TO MEETING FEDERAL REQUIREMENTS FOR STATE ELIGIBILITY SYSTEMS

The expansion of the Texas Medicaid program and other entitlement programs requires that the TIERS system have the capacity to process a significant increase in eligibility determination caseloads. System modifications that states implement must streamline the processing of current and future eligibility criteria for individuals included in the ACA Medicaid expansion. State, federal and private HIXs will share eligibility information. To accommodate the shared exchange of eligibility information, state eligibility systems must implement technology that tests client eligibility by using both the current income test methodology and a new modified adjusted gross income (MAGI) methodology. This functionality must be operational by the end of December 2013. The current methodology disregards several items from an applicant's personal income, such as work and dependent-care expenses. The MAGI methodology disregards 5 percent of the applicable Federal Poverty Level (FPL) and does not apply an asset limit. Additional system modifications are also required for states that expand eligibility to qualifying adults. Guidance from CMS on additional adjustments and conversion methodology is expected in fiscal year 2013. Other eligibility program and system modification challenges include the following issues:

- ability of state programs to rely primarily on electronic data for eligibility verification;
- ensuring safe and secure delivery and use of digital services to protect information and privacy;
- providing computer, phone, mail, or in-person application options to applicants;
- coordinating eligibility data across multiple technology platforms;
- processing eligibility and enrollment in real time; and
- having adequate financial and human resources.

TIERS implemented some of the required technological modifications in the current biennium through its Client Portal Modernization Implementation project. Certain cross-program components will need to be addressed in TIERS. For example, CHIP and TIERS case management are on separate systems. Conversion and transfer of CHIP recipient files to TIERS system files is planned. Successful self-service functionality is dependent upon this file conversion and transfer.

The State Health Access Data Assistance Center (SHADAC), in conjunction with HHS surveyed states to determine the progress related to Medicaid Eligibility Determination Implementation pursuant to the ACA. The survey results, published in June 2012, shows 27 states are relying on legacy systems (10 to 40 years old). Only five states have implemented newer systems during the past 10 years. Newer systems are typically categorized as having web-based capability. The survey identified California, Michigan, Mississippi, Oklahoma, and Texas as having newer systems. The Kaiser Commission on Medicaid and the Uninsured reported in July 2012 that 48 states have been approved for enhanced funding of their Medicaid Eligibility and Enrollment system upgrades.

TEXAS ELIGIBILITY MODERNIZATION PLAN

CMS approved enhanced federal match for the first project of HHSC's TIERS modernization plan in April 2012. The first project of the TIERS plan, the Client Portal Modernization Implementation program, is also referred to as APD 1. APD 1 received a federal match rate between 50 percent and 90 percent for the TIERS modernization program in fiscal year 2012. HHSC reported the enhanced federal match for APD 1 totaled $13.3 million or 78.3 percent of the $16.9 million in total costs. All of the TANF-related modifications were paid for with TANF state and federal funds. HHSC submitted APD 2 for TIERS to CMS in August 2012 and renamed the project Enhanced Eligibility Systems Modernization. APD 2 includes project implementation from October 2012 to December 2013 and will make modifications to three key areas: (1) Eligibility Modernization, (2) Electronic Submissions, and (3) Income Verification (applying MAGI). HHSC again estimates between 50 percent and 90 percent federal match rate for implementation costs in APD 2. The plan shows the combined implementation costs for APD 1 and APD 2 by the end of December 2013 will total approximately $148.2 million in All Funds ($110.3 million in Federal Funds and $38.0 million in General Revenue Funds).

Enhanced Eligibility Systems Modernization will include the following modifications:

- expanding two-way electronic communications between clients and HHSC;
- increasing self-service channels allowing clients and community based organizations to apply for or seek a redetermination of benefits;
- further integrating staff workflow management to allow optimal distribution of work across the state;
- automating text recognition and indexing of case documentation;
- streamlining development to update, enhance, and modify maturing services-oriented architecture;
- routing CHIP and Medicaid applications and processing through a single portal; and
- implementing streamlined Medicaid application processing rules.

HHSC also identifies an estimated cost savings in APD 2 of $117.7 million in All Funds from fiscal years 2014 to 2017. The cost savings are due to a planned migration of the CHIP eligibility determination process from a contractor's system to TIERS. The four-year savings is estimated to be $83.7 million in Federal Funds and $34.0 million in General Revenue Funds and must be approved by CMS. Savings for the 2014–15 biennium are estimated at $54.8 million, which includes $39.0 million in Federal Funds and $15.8 million in General Revenue Funds. HHSC's plan to integrate Medicaid and CHIP into one eligibility system will consolidate operations for the eligibility system and maximize resources for federally required technology modifications and management of future caseload growth. **Figure 4** shows

FIGURE 4
STATE AND FEDERAL COSTS FOR TEXAS INTEGRATED ELIGIBILITY AND REDESIGN SYSTEM – ENHANCED ELIGIBILITY SYSTEMS MODERNIZATION
FISCAL YEARS 2012 AND 2013

(IN MILLIONS)

ADVANCE PLANNING DOCUMENT 1 – PROJECT PERIOD FROM OCTOBER 2011 TO SEPTEMBER 2012

FEDERAL PROGRAM	FEDERAL COST SHARE	STATE COST SHARE	ALL FUNDS	FEDERAL FINANCIAL PARTICIPATION RATE
Medicaid – Development	$1.3	$1.3	$2.5	50.00%
Medicaid – Development	10.0	1.1	11.2	90.00
Medicaid – Operations	1.0	0.3	1.4	75.00
Children's Health Insurance Program - Operations	0.1	0.1	0.2	70.75
Supplemental Nutrition Assistance Program Expansion – Operations	0.9	0.9	1.7	50.00
Advance Planning Document 1 Subtotal	**$13.3**	**$3.7**	**$17.0**	**78.60%**

ADVANCE PLANNING DOCUMENT 2 – PROJECT PERIOD FROM OCTOBER 2012 TO DECEMBER 2013

FEDERAL PROGRAM	FEDERAL COST SHARE	STATE COST SHARE	ALL FUNDS	FEDERAL FINANCIAL PARTICIPATION RATE
Medicaid – Development	$41.6	$4.6	$46.2	90.00%
Medicaid – Operations	15.6	5.2	20.8	75.00
Children's Health Insurance Program – Operations	20.6	8.5	29.1	70.75
Supplemental Nutrition Assistance Program Expansion – Operations	16.0	16.0	31.9	50.00
Temporary Assistance for Needy Families Expansion – Operations	3.2	-	3.2	100.00
Advance Planning Document 2 Subtotal	**$97.0**	**$34.3**	**$131.2**	**73.84%**
Total Project Costs	**$110.3**	**$38.0**	**$148.2**	**74.39%**

Notes: The figure shows a 50 percent match rate for Medicaid for Advance Planning Document 1 projects performed from October 2011 through March 2012. Enhanced federal match became effective beginning in April 2012 for both Advance Planning Documents 1 and 2. Totals may not sum due to rounding.
Source: Health and Human Services Commission.

federal and state costs and program cost allocation for the Enhanced Eligibility Systems Modernization projects.

STATE TRACKING OF ELIGIBILITY MODERNIZATION SYSTEM COSTS

Information technology development projects are reported by state agencies in the Texas Project Delivery Framework, Project Monitoring Report to the Quality Assurance Team (QAT). QAT is a group of state agency representatives that reviews the status of technology projects and makes recommendations to the Texas Legislature to reduce risk of project overruns and failures. It is comprised of staff from the Legislative Budget Board (LBB), the State Auditor's Office (SAO), and the Department of Information Resources (DIR). Projects reviewed by the QAT must have development costs greater than $1 million and meet one or more of the following criteria:

- requires one year or more to reach operational status;
- involves more than one agency or governmental unit; or
- materially alters the work methods of agency or university personnel or the delivery of services to agency or university clients.

In December 2010, HHSC reported a cost projection of approximately $85 million (All Funds) to make modifications to a state HIX system and to update TIERS pursuant to ACA requirements. HHSC planning documents show that TIERS modernization alone will exceed original cost estimates for both the HIX system and the eligibility system.

December 2013 is a key federal deadline for healthcare reform compliance and marks the end of TIERS implementation of APD 1 and APD 2 projects. HHSC has stated that future modifications to APD 2 and additional APDs may be necessary. Meeting federal requirements for operational readiness by December 2013 will allow HHSC to apply for enhanced FFP of 75/25 for ongoing operations and maintenance of TIERS through fiscal year 2015. HHSC anticipates that enhanced FFP for operations and maintenance will begin on January 1, 2014 and continue indefinitely for the Medicaid-related components of TIERS. At that time, non-Medicaid components of eligibility systems will receive applicable match rates for operations and maintenance.

Any changes in federal timelines and guidelines will affect HHSC's project cost estimates and future Legislative Appropriation Requests. As mentioned previously, state agencies must report technology projects of $1 million or more to QAT. Agencies have the option to enter information on additional costs or cost savings in Section 2.2 of their Texas Project Delivery Framework, Project Monitoring Report. Recommendation 1 would include a rider in the introduced 2014–15 General Appropriations Bill to direct HHSC to include the fiscal impact of the federal Eligibility Modernization Program from fiscal years 2012 to 2015 in Section 2.2 of the Texas Project Delivery Framework, Project Monitoring Report to QAT. HHSC should identify reduced costs or savings achieved through participation in the federal Eligibility Modernization Program through fiscal year 2015 as part of their Project Monitoring Report for the QAT.

FISCAL IMPACT OF THE RECOMMENDATION

Recommendation 1 can be implemented with existing agency and state resources and have no fiscal impact.

The introduced 2014–15 General Appropriations Bill includes a rider to implement this recommendation.

PROVIDE OVERSIGHT OF MANAGED CARE ORGANIZATIONS TO ENSURE APPROPRIATE USE OF STATE FUNDS

The State of Texas Access Reform Plus (STAR+PLUS) program is a capitated Medicaid service delivery model that integrates acute and long-term services and supports. The Health and Human Services Commission contracts with five managed care organizations in ten service areas to provide STAR+PLUS services to certain consumers who are aging and/or have physical disabilities. Within STAR+PLUS, consumers may receive home and community-based services and supports if they qualify. The monthly premiums paid by the Health and Human Services Commission to managed care organizations for persons receiving STAR+PLUS home and community-based services and supports waiver services are significantly higher than the monthly premiums for other clients in the STAR+PLUS program. The managed care organizations are responsible for assessing a consumer's need for services and submitting documentation used to determine if the assessed consumer is functionally eligible to receive services. Given the managed care organizations' financial incentive to recommend enrollment of persons in the STAR+PLUS home and community-based services and supports waiver and a lack of sufficient controls in this process, the state is at risk of paying a higher level of premiums than is necessary. Expansion of the STAR+PLUS program magnifies this risk. Implementation of a utilization review process at the Health and Human Services Commission's Office of Inspector General for the STAR+PLUS program would provide state oversight and deter inappropriate client placements in STAR+PLUS home and community-based waiver services. The process would also provide a means for measuring any occurrences of inappropriate placements.

FACTS AND FINDINGS

- ♦ Consumers in STAR+PLUS have complex needs and are some of the most costly Medicaid enrollees. Some persons in this program qualify to receive home and community-based long-term services and supports. These consumers receive services like those provided in the Medicaid 1915(c) Community-based Alternatives program at the Department of Aging and Disability Services.
- ♦ The capitated, per member per month premiums paid to STAR+PLUS managed care organizations for clients receiving STAR+PLUS home and community-based services and supports waiver services are significantly higher than the monthly premiums for other clients in the STAR+PLUS program.
- ♦ From fiscal years 2008 to 2011, enrollment in STAR+PLUS increased by 42.4 percent while the number of consumers receiving STAR+PLUS home and community-based services and supports waiver services has increased by 134.2 percent.
- ♦ From its inception in fiscal year 1998 to fiscal year 2011, Texas has expanded the STAR+PLUS program from a pilot in Harris County to a program serving 219,975 consumers in multiple service areas.

CONCERN

- ♦ A financial incentive exists for STAR+PLUS managed care organizations to recommend inappropriate placement of persons in STAR+PLUS home and community-based services and supports waiver services, given that the monthly premium payment methodology provides higher payments for persons receiving STAR+PLUS home and community-based services and supports waiver services and the administrative payment methodology is linked to the total premiums received. This could increase premium and administrative costs incurred by the Health and Human Services Commission.
- ♦ The Medicaid claims administrator, the entity responsible for determining STAR+PLUS home and community-based services and supports waiver eligibility, may not detect an inappropriate request for services because the managed care organization that stands to benefit from the decision supplies the information used to make the medical necessity/level of care determination.
- ♦ Limited use of utilization review in the Texas managed care service delivery models minimizes the state's ability to detect inappropriate placement of persons in the STAR+PLUS home and community-based services and supports waiver.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Amend statute to require the Office of Inspector General to establish an annual utilization review process for managed care organizations in the STAR+PLUS program that includes review of functional assessment activities.
- ♦ **Recommendation 2:** Include a contingency rider in the introduced 2014–15 General Appropriations Bill to transfer $761,741 in General Revenue Funds from strategy B.1.2, Medicaid Disability-Related to G.1.1, Office of Inspector General, and to increase the agency's full-time equivalent cap by 9.0 for the purpose of conducting utilization review in the STAR+PLUS program.

DISCUSSION

STAR+PLUS (State of Texas Access Reform Plus) is a capitated Medicaid service delivery model that integrates acute and long-term services and supports for eligible consumers who are aging and/or have physical disabilities. According to the Health and Human Services Commission (HHSC), persons who are aging and/or have physical disabilities comprise about 25 percent of the Texas Medicaid caseload, but nearly 58 percent of the costs. The STAR+PLUS model was developed to reduce the costs of treating this group and improve the coordination of care. Evaluations of STAR+PLUS support the argument that provision of service coordination and integration of long-term services and supports to a high-needs and high-cost population can result in cost avoidance. A 2004 Lewin Group study found integration of acute care and community based long-term care services increased cost savings related to caring for aging and disabled persons by 70 percent. A 2009 Deloitte report found that compared to fee-for-service Medicaid, STAR+PLUS saves 22 percent in in-patient spending; 15 percent in acute outpatient care (including emergency department care); 15 percent in non-physician services, ambulatory care, home health, and behavioral health; and 10 percent in long-term services and supports.

HHSC operates the STAR+PLUS program under the authority of a federal 1115 demonstration waiver. HHSC had previously operated the program under the authority of one Medicaid 1915(b) and two 1915(c) waivers. Now that Texas has implemented the 1115 transformation waiver, STAR+PLUS has been transferred into the new waiver with its name, structure, and design intact.

Program enrollment is mandatory for adults residing in a STAR+PLUS service area who meet one or more of the following criteria:

- have a physical or mental disability and qualify for Supplemental Security Income (SSI) or for Medicaid due to low income;
- qualify for STAR+PLUS Home and Community-based Services and Supports (HCBS); and
- receive Medicaid because they are in a Social Security Exclusion program and meet financial criteria for STAR+PLUS HCBS services.

Children younger than age 21 receiving SSI may voluntarily enroll in STAR+PLUS.

According to the Texas Administrative Code, persons ineligible for the program include:

- residents of nursing facilities;
- STAR+PLUS members who have been in a nursing facility for more than four consecutive months/120 days;
- persons receiving Medicaid 1915(c) waiver services (excluding Community-based Alternatives);
- residents of Intermediate Care Facilities for Individuals with Intellectual Disabilities;
- persons not eligible for full Medicaid benefits; and
- children in the conservatorship of the Texas Department of Family and Protective Services.

STAR+PLUS began in the Harris County service area in 1998. The program expanded to the Bexar, Travis, Nueces, and Harris Contiguous service areas in 2007. In 2011, the program expanded to include the Dallas and Tarrant service areas and to the contiguous counties of the Harris, Bexar, Nueces, and Travis service areas. In March 2012, HHSC expanded STAR+PLUS into certain counties of the Lubbock and El Paso service areas and into 10 counties in South Texas (Hidalgo service area).

Figure 1 shows the growth in program enrollment and expenditures as expansion has occurred. Consumers are split between two categories: those who receive STAR+PLUS because they are aged and/or Medicare-eligible (also known as "dual eligibles") and persons with disabilities (Supplemental Security Income "SSI"-eligible).

FIGURE 1
STAR+PLUS ENROLLMENT AND EXPENDITURES
FISCAL YEARS 2008 TO 2011

FISCAL YEAR	ENROLLMENT	AVERAGE PER MEMBER/PER MONTH PREMIUM	PREMIUM EXPENDITURES (IN MILLIONS)
2008	154,494	$464.24	$860.7
2009	159,969	$492.10	$944.6
2010	166,536	$562.86	$1,124.9
2011	219,975	$545.08	$1,438.8

Note: Premium expenditures column does not reflect acute care costs for aged and Medicare-related (paid for by Medicare or outside the premiums) or inpatient hospital costs for disabled and blind (these services were carved-out of the rate for the years shown in the chart).
Source: Health and Human Services Commission.

OVERVIEW OF STAR+PLUS SERVICES

At enrollment, Medicaid clients choose a managed care organization (MCO) participating in the STAR+PLUS program and within 30 days, receive an assessment to determine an appropriate plan of care. The MCO coordinates acute and long-term services for the individual; service coordination is a defining feature of the program.

Medicaid-only clients (those who are not also receiving Medicare) enrolled in STAR+PLUS may access any medically necessary acute care services available under fee-for-service Medicaid. This includes accessing services carved-in to the capitation rate and those that are not (e.g., medical transportation and nursing facility services). In conjunction with the March 2012 expansion, the Legislature directed HHSC to implement some program changes, including carving (only for clients with disabilities) non-behavioral health inpatient hospital and prescription drugs into the managed care rates for STAR+PLUS. These services were previously available to STAR+PLUS consumers but paid for using a fee-for-service methodology. For consumers who are dually eligible for Medicare and Medicaid services ("dual eligibles"), the STAR+PLUS program only provides long-term care services; these individuals receive acute care services through Medicare. Adult clients in STAR+PLUS receive enhanced benefits compared to persons served under fee-for-service Medicaid, including: (1) a waiver of the three prescription per month limit (for members not Medicare-eligible), (2) a waiver of the 30-day spell-of-illness limit, and (3) waiver of the $200,000 annual individual limit for inpatient services.

The STAR+PLUS program provides clients with access to a continuum of long-term services and supports. Some long-term care services (attendant care and day activity services) are available to all STAR+PLUS clients. Clients who receive only acute and these long-term care services and who do not require additional home and community-based services are known as Other Community Care clients. Clients with more extensive long-term care needs are enrolled in the STAR+PLUS home and community-based services and supports waiver (herein STAR+PLUS HCBS waiver) program, which provides home and community-based services and supports similar to those provided under the Medicaid 1915(c) Community-based Alternatives (CBA) waiver program operated by the Department of Aging and Disability Services (DADS). **Figure 2** shows the STAR+PLUS acute and long-term services array. Managed care organizations may opt to provide value-added services in addition to those shown in **Figure 2**. Value-added services are services managed care organizations provide that are not required in their contract with the state. They provide these services to help manage the cost and risks of patients for whom they provide care.

OVERVIEW OF STAR+PLUS RATES

HHSC contracts with five MCOs in ten service areas for the STAR+PLUS program. The MCOs receive a per member/per month premium payment based on the client type. In addition to varying by client type, premiums vary by service area and in some cases, MCO, to reflect differences in client acuity as **Figure 3** shows. In 2011, for Medicaid-only clients, the premiums for STAR+PLUS HCBS waiver clients were 3.6 to 6.1 times greater than the premiums for Other Community Care clients (varies by service area and MCO). For dual eligible clients, the premiums for STAR+PLUS HCBS waiver clients were 4.5 to 10.3 times greater than the premiums for Other Community Care clients.

STAR+PLUS HCBS WAIVER SERVICES

The STAR+PLUS HCBS waiver services are available to persons in the STAR+PLUS program whom:

- meet medical necessity/level-of-care criteria (MN/LOC) for nursing facility placement;
- have an annual service plan cost that does not exceed the cost limit (202 percent of the cost of serving an individual in an institutional setting based on Resource Utilization Group level);
- have an unmet need for at least one waiver service;

FIGURE 2
STAR+PLUS SERVICE ARRAY, 2012

ACUTE SERVICES	LONG-TERM CARE SERVICES AVAILABLE TO OTHER COMMUNITY CARE CLIENTS	STAR+PLUS HCBS WAIVER SERVICES
• Ambulance services	• Personal attendant services	• Personal attendant services
• Audiology services including hearing aids (adults)	• Day activity health services	• Assisted living
• Behavioral health services		• Emergency response services
• Prenatal care and birthing services by specified providers in a licensed birthing center		• Nursing services
• Cancer screening, diagnostic, and treatment services		• Day activity health services
• Chiropractic services		• Adult foster care
• Dialysis		• Dental
• Durable medical equipment and supplies		• Respite
• Early Childhood Intervention Services		• Home delivered meals
• Emergency services		• Therapies (physical, occupational, speech)
• Family planning services		• Consumer directed services
• Home healthcare services		• Transition assistance services
• Hospital services (inpatient and outpatient)		• Financial management services
• Laboratory		• Minor home modifications
• Mastectomy, breast reconstruction, and related follow-up procedures		• Adaptive aids
• Medical check-ups and Comprehensive Care Program Services for children through the Texas Health Steps Program		• Medical supplies
• Oral evaluation and fluoride varnish in the medical home in conjunction with Texas Health Steps medical check-up		
• Optometry, glasses, and contact lenses (if medically necessary)		
• Drugs and biologicals provided in an inpatient setting		
• Podiatry		
• Prenatal care		
• Primary care services		
• Preventive services		
• Radiology, imaging, and x-rays		
• Specialty physician services		
• Therapies (speech, occupational, physical)		
• Transplantation of organs and tissues		
• Vision		

Note: This figure contains only services and benefits provided to STAR+PLUS members through MCOs. It excludes additional services available to Medicaid members that are carved-out of MCO rates and financed on a fee-for-service basis.
Source: Health and Human Services Commission.

- are at-risk for nursing facility placement; and
- have full Medicaid coverage.

Services provided under the STAR+PLUS HCBS waiver (as identified in **Figure 2**) are comparable to the CBA waiver program operated by DADS. STAR+PLUS operates, primarily, in urban areas, whereas the CBA waiver program operates in non-STAR+PLUS counties (primarily rural areas). A key difference between the programs is that for the Supplemental Security Income (SSI) population,

FIGURE 3
MANAGED CARE ORGANIZATION PREMIUMS, FISCAL YEAR 2011

ORGANIZATION	MEDICAID ONLY OTHER COMMUNITY CARE	MEDICAID ONLY STAR+PLUS WAIVER	DUAL ELIGIBLE OTHER COMMUNITY CARE	DUAL ELIGIBLE STAR+PLUS WAIVER
Amerigroup – Bexar	$528.09	$2,960.76	$270.12	$1,672.83
Molina – Bexar	$501.84	$2,673.82	$270.12	$1,672.83
Superior – Bexar	$595.57	$2,834.14	$270.12	$1,672.83
Dallas	$467.30	$2,397.24	$178.91	$1,182.57
Amerigroup – Harris	$630.97	$3,371.40	$227.94	$1,488.08
Evercare – Harris	$698.41	$3,183.79	$227.94	$1,488.08
Molina – Harris	$606.83	$3,391.79	$227.94	$1,488.08
Evercare – Nueces	$749.33	$2,666.38	$357.31	$1,606.63
Superior – Nueces	$813.20	$2,905.47	$357.31	$1,606.63
Tarrant	$505.80	$2,594.75	$138.05	$912.50
Amerigroup – Travis	$628.28	$3,814.44	$175.39	$1,803.90
Evercare – Travis	$586.00	$3,318.62	$175.39	$1,803.90

Notes: Fiscal year 2011 rates reflect revisions for one percent provider rate reduction and February 1, 2011 implementation of STAR+PLUS in the Dallas and Tarrant service areas.
Source: Health and Human Services Commission.

STAR+PLUS HCBS waiver services are available as an entitlement, whereas in CBA areas, provision of services is limited by the number of slots appropriated by the Legislature. This means that in STAR+PLUS, the state is responsible to pay for waiver services for all SSI-eligible persons and there is no wait for services, although there is an interest list for persons with incomes between the SSI limit and 300 percent of the SSI limit (known as the "Medical Assistance Only" population). In contrast, in CBA, the state can limit provision of services. As of August 2012, there were 12,490 people on the STAR+PLUS interest list statewide (up to a five- to six-year wait) and 11,912 persons on the CBA interest list (one- to two-year wait).

As the STAR+PLUS program has expanded, the number of people enrolled to receive STAR+PLUS HCBS waiver services has also increased. However, growth in the number of people enrolled to receive these services has exceeded the rate of growth in the program, overall. From fiscal years 2008 to 2011, growth in the number of people enrolled to receive STAR+PLUS HCBS waiver services has been 134.2 percent, compared to a 42.4 percent increase in STAR+PLUS enrollment. **Figure 4** shows total program enrollment and STAR+PLUS HCBS waiver enrollment for fiscal years 2008 to 2011. Growth in the number of persons receiving STAR+PLUS HCBS waiver services is a major cost driver for the program given the difference in premiums.

STAR+PLUS HCBS WAIVER ELIGIBILITY DETERMINATION PROCESS LACKS CONTROLS

To receive STAR+PLUS HCBS waiver services, an individual must meet the medical necessity/level-of care (MN/LOC) institutional admission criterion (criterion for admission to a nursing facility). HHSC is responsible for determining financial and functional eligibility for the program. However, the agency has delegated components of the functional eligibility determination process to other entities. The functional eligibility determination process determines whether an individual has a need for program services because they are aging or have a physical disability.

MCO staff or contractors conduct functional assessments and complete documentation including the Form 2333 (Nursing Facility At-Risk Assessment) and the MN/LOC assessment. The MN/LOC assessment was developed by HHSC and DADS based on the MDS 3.0, a nationally used and federally required assessment related to nursing facility admission. The MCO submits the MN/LOC assessment to the Medicaid claims administrator, Texas Medicaid and Healthcare Partnership (TMHP).

TMHP makes a determination of MN/LOC based on information the MCO submits, and assigns a Resource Utilization Group (RUG) that is used in determining a cost cap for the individual's plan of care. The cost cap provides the maximum cost for the client's individual service plan. It is based on 202 percent of the institutional cost of serving the

FIGURE 4
AVERAGE MONTHLY CASELOAD, FISCAL YEARS 2008 TO 2011

					PERCENTAGE OF GROWTH			
CATEGORY	2008	2009	2010	2011	2008 TO 2009	2009 TO 2010	2010 TO 2011	2008 TO 2011
Aged and Medicare-related (Dual Eligibles)								
STAR+PLUS HCBS Waiver Services	6,534	8,551	10,305	14,242	30.9	20.5	38.2	118.0
Other Community Care	75,260	76,177	76,908	100,391	1.2	1.0	30.5	33.4
Nursing Facility	401	430	465	645	7.2	8.1	38.7	60.8
Subtotal	82,195	85,158	87,678	115,277	3.6	3.0	31.5	40.2
Disability-related (SSI Eligible)								
STAR+PLUS HCBS Waiver Services	1,672	2,465	3,622	4,977	47.4	46.9	37.4	197.7
Other Community Care	70,488	72,202	75,069	99,449	2.4	4.0	32.5	41.1
Nursing Facility	140	145	167	272	3.6	15.2	62.9	94.3
Subtotal	72,300	74,811	78,858	104,698	3.5	5.4	32.8	44.8
Total	**154,494**	**159,969**	**166,536**	**219,975**	**3.5**	**4.1**	**32.1**	**42.4**

Source: Health and Human Services Commission.

individual, which is related to the individual's RUG. After the individual's service plan is complete, DADS STAR+PLUS Support Unit reviews the plan to ensure it falls within the cost limit. **Figures 5** and **6** show key steps in the functional eligibility determination process and responsible entities for two groups of STAR+PLUS clients: persons not previously residing in a nursing facility and persons residing in a nursing facility.

MCOs are the entities that gather the information used in making the determination of eligibility for STAR+PLUS HCBS waiver services and stand to benefit, financially, when more clients receive STAR+PLUS HCBS waiver services due to the premium differential between clients receiving HCBS waiver services and Other Community Care STAR+PLUS clients. If clients with lower relative levels of need are enrolled to receive HCBS waiver services and are not high users of services, some of the difference between the premiums paid and the cost of medical encounters for the individuals may be retained by the MCO as profit. In addition, increasing STAR+PLUS HCBS waiver enrollment also results in an increase in an MCO's administrative payment. HHSC pays MCOs a $12.50 per member/per month premium plus 5.75 percent of gross premiums for administrative expenses for each member in the STAR+PLUS HCBS waiver.

The extent to which MCOs are recommending enrollment in STAR+PLUS HCBS waiver for persons whose needs

FIGURE 5
STAR+PLUS HCBS WAIVER PROGRAM FUNCTIONAL ELIGIBILITY PROCESS – NON-NURSING FACILITY CLIENT, 2012

ORDER	FUNCTION	ENTITY(IES) RESPONSIBLE
1	Completion of Form 2333/ Nursing Facility At- Risk Assessment	Managed Care Organization (MCO) nurse/contracted nurse
2	MN/LOC assessment	MCO nurse/contracted nurse completes the assessment; Physician signature required
3	Medical necessity determination (level of care determination)	TMHP; if denied, must be reviewed by medical director at TMHP; MCO must have opportunity to submit additional information
4	Resource Utilization Group (RUG) assigned to client	TMHP
5	Form 3671/Individual Service Plan (multiple attachments) developed and based on constraint of 202 percent of RUG	MCO nurse/contracted nurse

Source: Legislative Budget Board.

FIGURE 6
STAR+PLUS HCBS WAIVER FUNCTIONAL ELIGIBILITY PROCESS – NURSING FACILITY CLIENT, 2012

ORDER	FUNCTION	ENTITY(IES) RESPONSIBLE
1	Client expresses desire to live in the community MCO identifies potential client who could move to community	Client/MCO
2	DADS STAR+PLUS Support Unit makes contact with client; determines whether client has current MN determination.	STAR+PLUS Support Unit (see question below)
3	MN/LOC assessment completed for client without current MN/LOC (avoid duplication). No new MN/LOC assessment required for client with current MN/LOC.	MCO nurse/contracted nurse completes the assessment; Physician signature required For client with current MN, MCO uses existing RUG in development of ISP. For client applying for Medicaid as a resident in NF concurrently applying for STAR+PLUS HCBS waiver services, NF completes MN/LOC assessment.
3a	Medical necessity determination (level of care determination) (as needed)	Determination: TMHP; if denied, must be reviewed by medical director at TMHP; MCO must have opportunity to submit additional information
3b	RUG assigned to client (as needed)	TMHP
4	Form 3671/Individual Service Plan developed and based on constraint of 202 percent of RUG.	MCO Nurse/Contracted Nurse

Source: Legislative Budget Board.

could be met with a less robust package of services is unknown. However, growth in the number of clients receiving STAR+PLUS HCBS waiver services relative to the program, as a whole, suggests this could be occurring. In addition, HHSC's Office of Inspector General (OIG) conducted a 2012 audit of the Evercare (now United Healthcare) MCO and one category of significant errors found was ineligible members being enrolled in STAR+PLUS HCBS waiver services. Of the 224 member records sampled, 143 had significant errors. Of these records, 10 (7 percent) resulted in inappropriate enrollment in STAR+PLUS HCBS waiver services. The additional annual premiums paid for this population are estimated to be $324,000.

There are controls built into the oversight of MCOs, generally, and the eligibility determination process, specifically, that may serve as checks against this incentive, but they may not provide strong deterrents:

- HHSC collects Experience Rebates from MCOs, which limit plans' abilities to retain profit. MCOs retain all profit up to 3 percent. Plans retain a portion of the profit earned from 3 percent to 12 percent (above 12 percent, HHSC collects 100 percent of the profits earned).
- Rates are adjusted and should theoretically be reduced to account for reduced client acuity, if lower needs persons were being served in STAR+PLUS; however, they are typically adjusted annually so premiums could be artificially high for a year or more before they are corrected and, by that point, there may be new persons enrolled in the waiver that are impacting costs.
- The External Quality Review Organization will be conducting quality reviews under the new 1115 demonstration waiver that will include some examination of the eligibility and client assessment processes, as well as service planning. This could identify some inappropriate requests for service, but due to the focus of reviews, this may not be a strong deterrent.
- A physician must sign off on the MN/LOC, but that physician is the applicant's/member's primary care physician who is a member of the MCO provider network.
- TMHP is the entity responsible for making the MN/LOC determination, but staff may not detect inappropriate requests for placement in HCBS waiver services because the MCOs supply most of the information they use in making the MN/LOC determination.

In addition to a lack of controls around the eligibility determination process that places the state at risk for paying a greater level of premiums and administrative payments than are necessary, until recently, STAR+PLUS MCOs have

not been subject to external (performed by an entity besides the MCO) utilization review. This limits the state's ability to detect inappropriate service provision and whether any MCOs are recommending individuals for enrollment in STAR+PLUS HCBS waiver services who do not require that level of care. Utilization review is a cost control mechanism used to review the appropriateness of service provision, given client needs. Utilization review could identify instances of over- and under-provision of services. Before fiscal year 2012, Medicaid MCOs, including those in the STAR+PLUS program, were not subject to any external utilization review. In contrast, many Texas Medicaid programs providing comparable services to a similar client base are subject to utilization review and cost recovery including hospitals, nursing facilities, and 1915(c) Medicaid waiver programs administered by DADS. For fiscal years 2009 to 2012, OIG identified estimated recoupments of $12.4 million based on actual errors in client records reviewed for nursing facilities (i.e., incorrect RUG, failure to document medical necessity). In fiscal year 2011, DADS utilization review staff reviewed MN/LOC determinations and RUGs levels for the CBA 1915(c) Medicaid waiver. Of the 229 cases sampled, 70 (31 percent) resulted in a RUG change, with a net cost difference of $456,116. The total value of cases in which medical necessity was later denied was $684,903.

Before the Evercare audit, Medicaid MCOs had not been subject to any external utilization review activities. According to the OIG, a new full-time audit unit has been established for MCOs and beginning in fiscal year 2013, four planned MCO audits will be conducted. These audits will occur across all programs (State of Texas Access Reform, STAR+PLUS, and Children's Health Insurance Program). Given the number of MCOs across these programs and the possibility that no STAR+PLUS MCOs could be reviewed if a given sample includes only STAR and CHIP MCOs, it is possible that this practice will not adequately deter MCOs from inappropriately recommending enrollment of consumers in STAR+PLUS HCBS waiver services. HHSC included an exceptional item request in the agency's fiscal years 2014–15 Legislative Appropriations Request for 101.6 additional full-time equivalents (FTEs) and a total of $37.6 million to expand OIG's capacity to conduct various activities, including but not limited to expanding utilization reviews of MCOs.

USING UTILIZATION REVIEW TO REDUCE INAPPROPRIATE PLACEMENT IN STAR+PLUS HCBS WAIVER

The role of STAR+PLUS MCOs in the assessment portion of the functional eligibility determination process and the financial incentive MCOs have to recommend inappropriate enrollment in STAR+PLUS HCBS waiver services creates a potential conflict of interest. In addition, existing controls are insufficient to deter improper enrollment in STAR+PLUS HCBS waiver services. Taken together, this places the state at risk of paying higher premiums than are required. The premium amount paid per client is a major cost driver of the program. This risk has increased in magnitude as the STAR+PLUS program has expanded to additional regions in Texas. As STAR+PLUS has expanded to the state's urban areas, it has become the primary program for long-term service and support delivery, replacing community care entitlement programs and certain 1915(c) waiver programs (i.e., CBA). The risk could increase if the Eighty-third Legislature, 2013, adopts HHSC's exceptional item to expand STAR+PLUS statewide.

Recommendation 1 would amend the Texas Government Code to require OIG to establish an annual utilization review process for STAR+PLUS MCOs. OIG would conduct a review of each STAR+PLUS MCO during the 2014–15 biennium and could use a risk-based process to identify which MCOs to review in subsequent years. OIG would retain discretion in selecting the topics for review, but would minimally be required to examine records related to client eligibility for STAR+PLUS HCBS waiver services. The recommendation would also require OIG to issue an annual report summarizing results of STAR+PLUS utilization reviews and to quantify records in error and extrapolate findings.

Implementation of an annual utilization review process in the STAR+PLUS program would increase the likelihood that the state could identify and correct for instances in which individuals are inappropriately enrolled in STAR+PLUS HCBS waiver services, and would serve as a deterrent for MCOs that have previously engaged in this practice. In addition, Recommendation 1 would result in additional benefits to the state given that other STAR+PLUS-related errors could be identified by implementing this process. For example, the OIG review of Evercare identified several other categories of errors, including delays in receiving services, personal attendant services hours, and member care issues, as part of $4.9 million in error in the sample.

Recommendation 1 assumes existing contractual authority regarding HHSC's ability to assess liquidated damages and recoup premiums paid in error is sufficient to enable HHSC to take corrective action if OIG reviews identify inappropriate enrollment in STAR+PLUS HCBS waiver services or other errors. This assumption is based on punitive actions taken by HHSC after completion of the Evercare (United) review.

Recommendation 2 would include a contingency rider in HHSC's bill pattern in the introduced 2014–15 General Appropriation Bill to transfer $761,741 in General Revenue Funds ($1,523,482 in All Funds) from Strategy B.1.2, Medicaid Disability-Related to G.1.1, Office of the Inspector General and increase OIG's full-time-equivalent cap by 9.0 to perform STAR+PLUS utilization review activities. This sum reflects the cost without benefits.

FISCAL IMPACT OF THE RECOMMENDATIONS

Figure 7 shows the five-year fiscal impact of the recommendations. There is no net fiscal impact for the 2014–15 biennium because reduced premiums would offset the cost of implementing a utilization review process for MCOs.

FIGURE 7
FIVE-YEAR FISCAL IMPACT, FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE ADDITION/(REDUCTION) OF FULL-TIME-EQUIVALENT POSITIONS
2014	9.0
2015	9.0
2016	9.0
2017	9.0
2018	9.0

SOURCE: Legislative Budget Board.

Because OIG has not previously performed utilization review of MCOs in the Medicaid program and CHIP, the agency does not have the resources to perform utilization review activities for the STAR+PLUS program without reducing other activities which may be required by statute. The recommendations assume 9.0 full-time-equivalent positions (FTEs) are needed based on performance assumptions (9 FTEs working on 4 reviews per year), at cost of $950,887 in General Revenue Funds for fiscal years 2014 and 2015. This cost includes salaries, benefits, new employee costs, and travel expenditures.

The recommendations assume that implementation of a utilization review process in STAR+PLUS would deter MCOs from recommending inappropriate placement in the more expensive STAR+PLUS HCBS waiver services and would therefore result in cost avoidance from reduced premiums paid to MCOs. The recommendations could also result in increased collections of liquidated damages from MCOs out of compliance with contractual obligations regarding enrollment in STAR+PLUS HCBS waiver services, and in any other areas of performance.

The introduced 2014–15 General Appropriations Bill includes a rider to implement Recommendation 2.

REQUIRE NON-PHYSICIAN MEDICAID SERVICES BE REIMBURSED AT NON-PHYSICIAN RATES

Advanced practice nurses and physician assistants are healthcare providers educated and trained according to national standards to provide primary and acute care within limited scopes of practice in a variety of settings.

Healthcare providers communicate information about a patient's physician services to payers using a series of codes. These codes include Current Procedural Terminology codes, which describe medical and surgical services, and National Provider Identifier numbers, which identify the provider of the services. Health and Human Services Commission rules set Medicaid reimbursement rates for services provided by advanced practice nurses or physician assistants at 92 percent of the physician rate. However, other Health and Human Services Commission rules also allow these services to be reimbursed at 100 percent of the physician rate, even when a physician was not involved in the visit.

Amending statute to require services provided by advanced practice nurses and physician assistants be reimbursed at the designated rates would help contain Medicaid costs.

CONCERN

- ♦ Although Health and Human Services Commission administrative rules set Medicaid reimbursement for services provided by advanced practice nurses and physician assistants at 92 percent of the physician rate, agency rules also allow these services to be reimbursed at 100 percent of the physician rate.

RECOMMENDATION

- ♦ **Recommendation 1:** Amend statute to require that services provided by advanced practice nurses and physician assistants in the Medicaid program are billed and reimbursed at the rate set by the Health and Human Services Commission for these providers.

DISCUSSION

Medicaid, financed with both federal and state funds, is a healthcare program for certain low-income families, the elderly, and persons with disabilities. Texas Medicaid is administered by the Texas Health and Human Services Commission (HHSC). Medicaid acute care services are delivered primarily through managed care organizations. Certain clients may receive these services on a fee-for-service basis.

Physician services include office visits, surgical procedures, and a range of diagnostic and therapeutic services furnished in a variety of settings (such as physician's offices, hospitals, surgical centers, nursing facilities, clinical laboratories, and other settings). Physician services may be provided by advanced practice nurses and physician assistants. These mid-level providers are educated and trained according to national standards to provide primary, preventive, and acute care within limited scopes of practice in a variety of settings. In Texas, these providers have their ability to diagnose and prescribe delegated to them by a physician.

Healthcare providers communicate information about a patient's services to payers using a series of codes. These codes include Current Procedural Terminology (CPT) codes, which describe medical and surgical services, and National Provider Identifier (NPI) numbers, which identify the provider of the services. NPI numbers are issued by the Center for Medicare and Medicaid Services (CMS). The numbers were mandated in 2006 by the federal Health Insurance Portability and Accountability Act (HIPAA). NPIs are single, unchanging, 10-digit identifiers used for billing any kind of insurance (public or private). A claim to Medicaid, or other insurance, includes CPT codes associated with the services rendered, as well as an NPI to indicate the name and type of provider. Like physicians, mid-level providers have NPI numbers.

BACKGROUND ON TEXAS MEDICAID RATE SETTING

Reimbursement rates for Medicaid services are based on a service's relative value unit (RVU). CMS sets the RVU for a particular service based on the relative cost of the inputs that go into providing it: physician work, practice expenses, and professional liability insurance. RVUs are geographically adjusted by state-specific conversion factors. The Health and Human Services Commission (HHSC) determines the conversion factor for Texas by through its rate determination process. For services where CMS does not have an RVU, HHSC sets the rate by other methodologies.

Even after a state conversion factor is applied to a service's RVU, the reimbursement rate for a service may be adjusted upwards or downwards because of special circumstances. For instance, a modifying code can be used to indicate when a surgery required an assisting physician. That physician who assisted in the surgery would be reimbursed at a rate that is 16 percent of the primary surgeon's rate.

TEXAS MEDICAID REIMBURSEMENT OF SERVICES PROVIDED BY MID-LEVEL PROVIDERS

The state sets different rates for physician services provided by mid-level practitioners. Rules 355.8093, 355.8161, 355.8221, and 355.8281 in the Texas Administrative Code set the Medicaid reimbursement rates for services provided by physician assistants, certified nurse midwives, certified registered nurse anesthetists, and nurse practitioners and clinical nurse specialists, respectively, at 92 percent of the physician rate. These rules stipulate that the mid-level-provided services are billed using the mid-level provider number, and that laboratory services, x-ray services, and injections are reimbursed at the same rate regardless of whether they were ordered by a physician or mid-level provider. This means that any patient visit that could substitute a mid-level provider for a physician (such as a routine physical or treatment for allergies or high cholesterol) can be reimbursed at the 92 percent rate.

Although HHSC administrative rules set Medicaid reimbursement for services provided by advanced practice nurses and physician assistants at 92 percent of the physician rate, agency rules also allow these services to be reimbursed at 100 percent of the physician rate. Specifically, rule 354.1062 defines physician services as "those performed by the physician and those medical acts delegated by the physician to qualified and properly trained persons acting under the physician's supervision" and allows that "if the services are provided by a physician assistant or advanced practice nurse… the physician services are covered." This rule allows Medicaid services provided by an advanced practice nurse or physician assistant to be reimbursed at 100 percent of the physician rate.

According to HHSC, a Medicaid claim from a physician in individual practice is reimbursed at 100 percent of the physician rate, even if the claim identifies the rendering provider as an advanced practice nurse or physician assistant. Reimbursement for Medicaid claims from physician group practices is based on who the claim identifies as the service's rendering provider. If the rendering provider is identified as an advanced practice nurse or physician assistant, the claim billed by a physician group is reimbursed at the 92 percent rate. If the rendering provider is identified as a physician, then the claim billed by a physician group is reimbursed at the 100 percent rate. A claim that identifies a physician as the rendering provider may use a modifier code to identify a service that was actually rendered by an advanced practice nurse or physician assistant. However, there is no requirement that mid-level provided services be identified this way.

"INCIDENT TO" BILLING IN MEDICARE

Medicare has a somewhat similar allowance for reimbursing physician services rendered by mid-level providers called "incident to" billing. Under this policy, services rendered by an advanced practice nurse or physician assistant may be reimbursed at the physician rate when:

- the service follows up on a course of treatment initiated by a physician at the initial visit concerning that condition; and
- the physician must be physically present in the same office suite and immediately available to provide assistance and supervision.

The Medicare policy does not require the patient to see the physician at each visit, but it does hinge on the service being incidental to the physician's diagnosis or treatment of an injury or illness. The Texas practice is more permissive, allowing services provided by advanced practice nurses and physician assistant to be reimbursed at 100 percent of the physician rate as long as the provider is practicing in accordance with Texas Medical Board and Texas Board of Nursing rules.

AMOUNT OF TEXAS MEDICAID SERVICES REIMBURSED AT MID-LEVEL PRACTITIONER RATES

It is difficult to estimate how many Medicaid services provided by physician assistants and advanced practice nurses are reimbursed at the mid-level rate. According to HHSC, during fiscal year 2011 there were approximately 441,000 claims in the Medicaid fee-for-service program, or 1.4 percent of approximately 31.6 million physician-related fee-for-service Medicaid claims, that were reimbursed at the 92 percent rate. Texas Medicaid managed-care organizations had approximately 259,000 claims reimbursed at the mid-level provider rate. Combining the Texas Medicaid fee-for-service and managed care claims, for each advanced practice

nurse (excluding nurse anesthetists) and physician assistant licensed in Texas in 2011, there were approximately 50 claims reimbursed at the mid-level provider rate.

To further illustrate the issue, in calendar year 2011 approximately 10,500 Medicaid-covered childbirths occurred at a Texas hospital that used certified nurse-midwives (CNMs) with about 40 percent of its births. While this is not the same as saying 40 percent of their Medicaid-covered births were delivered by CNMs, it does imply that approximately 4,200 of those childbirths could have occurred with a CNM rather than a physician. According to HHSC, only 161 births covered by the Texas Medicaid program were reimbursed as CNM-attended births in calendar year 2011.

REQUIRING MID-LEVEL SERVICES TO BE REIMBURSED AT MID-LEVEL RATES

Recommendation 1 would amend the Texas Human Resources Code to require that Medicaid services rendered by advanced practice nurses and physician assistants are billed and reimbursed at the corresponding rate.

FISCAL IMPACT OF THE RECOMMENDATION

The fiscal impact of Recommendation 1 cannot be estimated because it is unknown how many Medicaid claims use a physician's NPI number to bill Medicaid when the service was provided by a physician assistant or advanced practice nurse. This change would reimburse fee-for-service Medicaid services rendered by advanced practice nurses or physician assistants at the 92 percent rate currently designated in HHSC rules. The state would realize an 8 percent savings for physician services that are actually provided by a physician assistant or advanced practice nurse.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of this recommendation.

REDUCE UNNECESSARY IN-OFFICE DIAGNOSTIC ANCILLARY SERVICES IN THE TEXAS MEDICAID PROGRAM TO CONTROL COSTS

Self-referrals occur when physicians refer patients to medical facilities in which the physicians have a financial relationship. Congressional concern with the implications of self-referral arrangements led to changes in the Social Security Act beginning in 1989 and a series of federal regulations that prohibit physicians from referring Medicare and Medicaid patients for certain health services at medical facilities in which they, or an immediate family member, have a financial relationship. Federal law provides an exception to the physician self-referral ban for some health services that meet the definition of an in-office ancillary service. In-office diagnostic ancillary services are a subset of in-office ancillary services and include clinical laboratory and radiology services.

National research has found that increased use of in-office diagnostic ancillary services may increase overall healthcare spending without shortening illness duration or improving patient convenience. The Health and Human Services Commission should take steps to reduce unnecessary in-office diagnostic ancillary services in the Texas Medicaid program, including analyzing in-office diagnostic ancillary service use, strengthening existing methods used to limit unnecessary diagnostic ancillary services, and adopting new cost-effective strategies to ensure appropriate use of these services. Efforts to ensure appropriate use of diagnostic ancillary services in general should also help reduce unnecessary in-office services. However, it may be helpful to place additional focus specifically on reducing unnecessary in-office diagnostic ancillary services. To the extent that implementing these strategies reduces unnecessary diagnostic ancillary services, there could be savings in the Texas Medicaid program.

FACTS AND FINDINGS

- From fiscal years 2008 through 2011, Texas Medicaid program spending on diagnostic ancillary services increased by 51.5 percent, from $562.1 million in All Funds to $851.7 million in All Funds. During this same period, overall Texas Medicaid program spending increased by 32.2 percent.
- The largest category of diagnostic ancillary service spending was laboratory services, representing 55.7 percent of total Medicaid program spending on diagnostic ancillary services in fiscal year 2011.
- The average amount spent per Medicaid client on diagnostic ancillary services in fiscal year 2011 was $298 for clients receiving services through a Medicaid managed care organization and $339 for clients receiving services through the Medicaid fee-for-service or primary care case management programs.
- The federal government has identified trends linking the increase in Medicare spending on certain diagnostic ancillary services to the in-office provision of these services. Data related to Texas Medicaid program spending on in-office diagnostic ancillary services is not available for this report due to limitations in ancillary services data the Health and Human Services Commission maintains.

CONCERN

- Despite national research findings that indicate the increased use of in-office diagnostic ancillary services may increase overall healthcare spending without improving patient outcomes, the Health and Human Services Commission has not identified the amount of in-office diagnostic ancillary services provided to Texas Medicaid clients. Furthermore, existing efforts to limit unnecessary diagnostic ancillary services in the Texas Medicaid program are not uniformly implemented across the program and may be insufficient to ensure appropriate use of these services, particularly in-office diagnostic ancillary services.

RECOMMENDATIONS

- **Recommendation 1:** Include a rider in the introduced 2014–15 General Appropriations Bill that would require the Health and Human Services Commission to collect data necessary to allow the agency to quantify the amount of in-office diagnostic ancillary services provided to clients in the Texas Medicaid fee-for-service and managed care programs and routinely analyze this data.
- **Recommendation 2:** Amend statute to direct the Health and Human Services Commission to strengthen existing methods used to limit unnecessary diagnostic ancillary services and adopt new cost-effective strategies to ensure appropriate use of these

services in the Texas Medicaid fee-for-service and managed care programs, including steps to improve payment accuracy for diagnostic ancillary services.

- ♦ **Recommendation 3:** Include a rider in the introduced 2014–15 General Appropriations Bill that would require the Health and Human Services Commission to submit a report on in-office diagnostic ancillary service use in the Texas Medicaid program to the Legislative Budget Board and the Office of the Governor by December 1, 2014. The report would include strategies the agency implements to reduce unnecessary diagnostic ancillary services.

DISCUSSION

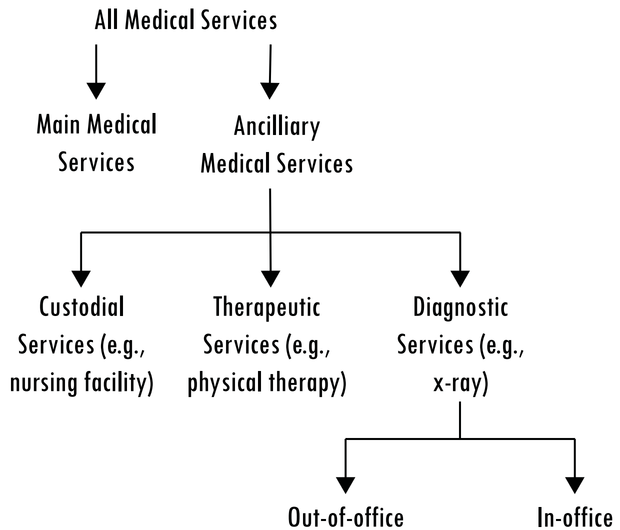
Medicaid, financed with both federal and state funds, is a healthcare program for low-income families, the elderly, and persons with disabilities. Texas Medicaid is administered by the Texas Health and Human Services Commission (HHSC). Medicaid acute services are delivered primarily through the fully capitated managed care organization (MCO) model also known as the State of Texas Access Reform (STAR) program. Certain clients may receive acute Medicaid services on a fee-for-service basis.

As shown in **Figure 1**, diagnostic ancillary services are a subset of a larger category of ancillary services and include clinical laboratory and radiology services. Diagnostic ancillary services are available to clients in the Texas Medicaid program. Laboratory services covered by the program include a complete blood count, urinalysis, and other laboratory testing specified in the *Texas Medicaid Provider Procedures Manual*. The following high-technology radiology services are a benefit of the program along with other radiology services specified in the *Texas Medicaid Provider Procedures Manual*:

- cardiac nuclear imaging;
- computed tomography (CT);
- computed tomography angiography (CTA);
- magnetic resonance imaging (MRI);
- functional MRI (fMRI);
- magnetic resonance angiography (MRA); and
- positron emission tomography (PET) scan imaging.

The types of providers that may bill the Texas Medicaid program for clinical laboratory and radiology services include:

FIGURE 1
ANCILLARY SERVICES DIAGRAM



SOURCE: Legislative Budget Board.

- independent laboratories;
- radiological laboratories;
- physiological laboratories;
- clinics;
- inpatient hospital providers;
- outpatient hospital providers;
- physicians; and
- advanced practice nurses.

SPENDING ON DIAGNOSTIC ANCILLARY SERVICES IN THE TEXAS MEDICAID PROGRAM

From fiscal years 2008 through 2011, Texas Medicaid program spending on diagnostic ancillary services increased by 51.5 percent, from $562.1 million in All Funds to $851.7 million in All Funds. During this same period, overall Texas Medicaid program spending increased by 32.2 percent. **Figure 2** shows Texas Medicaid program spending on diagnostic ancillary services in fiscal year 2011. The largest category of diagnostic ancillary service spending was laboratory services, representing 55.7 percent of total Medicaid program spending on diagnostic ancillary services in fiscal year 2011. The average amount spent per Medicaid client on diagnostic ancillary services in fiscal year 2011 was $298 for clients receiving services through a Medicaid MCO

FIGURE 2
SPENDING ON DIAGNOSTIC ANCILLARY SERVICES IN THE TEXAS MEDICAID PROGRAM BY TYPE OF SERVICE AND DELIVERY MODEL, FISCAL YEAR 2011

	MEDICAID MCO			MEDICAID FFS/PCCM			
SERVICE TYPE	AMOUNT PAID (IN MILLIONS)	CLIENT COUNT*	AVERAGE COST PER CLIENT	AMOUNT PAID (IN MILLIONS)	CLIENT COUNT*	AVERAGE COST PER CLIENT	TOTAL MEDICAID SPENDING (IN MILLIONS)
Laboratory	$238.1	1,255,942	$190	$236.7	1,233,085	$192	$474.8
CT	37.7	54,698	689	72.2	91,735	787	109.9
MRI	22.2	21,426	1,035	29.5	31,971	925	51.7
Nuclear Medicine	3.0	4,876	614	4.9	6,930	708	7.9
Ultrasound	54.8	173,430	316	55.5	226,130	245	110.3
X-ray and other standard imaging	40.3	300,530	134	56.8	421,788	135	97.1
Total	**$396.1**	**1,328,226**	**$298**	**$455.6**	**1,343,215**	**$339**	**$851.7**

*The total client count is unduplicated within the service delivery model.
Note: Data does not include Medicaid spending on claims primarily paid by Medicare.
Source: Texas Health and Human Services Commission.

and $339 for clients receiving services through the Medicaid fee-for-service or primary care case management (PCCM) programs.

FEDERAL BAN ON PHYSICIAN SELF-REFERRAL FOR DESIGNATED HEALTH SERVICES

Self-referrals occur when physicians refer patients to medical facilities in which the physicians have a financial relationship. Financial relationship is defined as (1) an ownership or investment interest in the entity, or (2) a compensation arrangement with the entity. Congressional concern with the implications of self-referral arrangements led to changes in the Social Security Act beginning in 1989 and a series of federal regulations that prohibit physicians from referring Medicare and Medicaid patients to receive designated health services at medical facilities in which they, or an immediate family member, have a financial relationship unless an exception applies (i.e., physician self-referral ban). Furthermore, the medical facilities may not bill Medicare or Medicaid for such services. The list of designated health services includes clinical laboratory and radiology services.

Congress' decision to pass legislation related to physician self-referral was based on studies that found that self-referral arrangements posed a conflict-of-interest since the physician was in a position to benefit financially from the referral. The studies found that such arrangements tended to encourage overutilization of services, which in turn drives up program costs because Medicare or Medicaid pays for more services than are medically necessary. The studies also contended that such arrangements create a captive referral system that limits competition among healthcare providers. Anti-competitive behavior can increase program costs if entities with which physicians have financial relationships are favored over more cost-efficient providers or providers that provide higher quality care. In its final rule on the physician self-referral prohibition implemented December 4, 2007, the Centers for Medicare and Medicaid Services stated that changes were enacted to "address over-utilization, anti-competitive behavior, and other program abuses that occur when physicians have financial relationships with certain entities to which they refer Medicare or Medicaid patients."

IN-OFFICE ANCILLARY SERVICES EXCEPTION

Federal law provides an exception to the physician self-referral ban for most designated health services, including clinical laboratory and radiology services, which meet the definition of an in-office ancillary service. Specifically, federal law allows physician self-referral for clinical laboratory and radiology services provided to Medicare and Medicaid patients if all of the following conditions are met:

- Services are provided by the referring physician, another physician in the same group practice as the referring physician, or by individuals directly supervised by the referring physician or another physician in the group practice.
- The services must be provided in (1) the same building in which the referring physician or other member of the group practice provides services unrelated to the furnishing of designated health services; or (2) in another building used for the centralized provision of

some or all of the group practice's designated health services.

- The services must be billed by the physician performing or supervising the service, by that physician's group practice, by an entity entirely owned by such physician or group practice, or by an independent third-party billing company acting as an agent of such physician, group practice, or entity.

According to the Center for Studying Health System Change 2008 Health Tracking Physician Survey, 25.2 percent of physicians in community-based, physician-owned practices reported that their practice owned or leased equipment for laboratory services, 22.7 percent for x-rays, 17.4 percent for advanced imaging (e.g., CT and MRI), 28.9 percent for noninvasive procedures other than electrocardiograms (e.g., nuclear testing, echocardiogram, treadmill, sleep studies, etc.), and 11.4 percent for invasive procedures (e.g., endoscopy).

The federal government has identified trends linking the increase in Medicare spending on certain diagnostic ancillary services to the in-office provision of these services. For example, the U.S. Government Accountability Office (GAO) found that the percentage of Medicare spending on imaging services performed in-office increased from 58 percent to 64 percent from 2000 to 2006. The GAO also found physicians in several specialties other than radiology who billed Medicare for in-office imaging services obtained an increasing share of their Medicare revenue from imaging. For example, from 2000 to 2006, cardiologists' share of Medicare revenue attributable to in-office imaging services increased from 23.2 percent to 36.0 percent. The same trend was evident for vascular surgeons, orthopedic surgeons, primary care physicians, and urologists. Similarly, in its 2011 report to Congress, the Medicare Payment Advisory Commission (MedPAC) stated that increased Medicare spending on imaging and other ancillary tests is partially due to physicians owning or leasing diagnostic testing equipment.

IN-OFFICE DIAGNOSTIC ANCILLARY SERVICES MAY LEAD TO UNNECESSARY USE AND SPENDING

Supporters of the in-office ancillary services exception contend that it provides the convenience of one-stop service and expedites the care process. Specifically, they argue that in-office ancillary services lead to earlier testing, a faster and more accurate diagnosis, quicker initiation of treatment, shorter illness duration, and lower overall spending per episode of care. However, national research findings indicate that increased use of in-office diagnostic ancillary services may increase overall healthcare spending without shortening illness duration or improving patient convenience. **Figure 3** summarizes studies recently published in the peer-reviewed journal *Health Affairs* that discuss the impact of in-office diagnostic ancillary services as well as a study by MedPAC.

REDUCE UNNECESSARY IN-OFFICE DIAGNOSTIC ANCILLARY SERVICES IN THE TEXAS MEDICAID PROGRAM

Despite national research findings that indicate the increased use of in-office diagnostic ancillary services may increase overall healthcare spending without shortening illness duration or improving patient convenience, HHSC has not identified the amount of in-office diagnostic ancillary services provided to Texas Medicaid clients. One method federal government and national researchers use to quantify a portion of in-office diagnostic ancillary services is to identify claims where the National Provider Identifier (NPI) is the same for both the provider who ordered the service and the provider who performed the service. This type of data in the Texas Medicaid claims processing system used for the Texas Medicaid fee-for-service program is incomplete. Specifically, the Texas Medicaid claims processing system includes a field for the NPI for the ordering provider as well as the provider who performed the service. However, the NPI for the ordering provider is not required on all claims and therefore, the corresponding field in the Texas Medicaid claims processing system is not consistently populated. Similarly, some of the STAR and STAR+PLUS MCOs do not require that claims include the ordering provider's NPI.

Recommendation 1 would include a rider in the introduced 2014–15 General Appropriations Bill that would require HHSC to collect data necessary to allow the agency to quantify the amount of in-office diagnostic ancillary services provided to clients in the Texas Medicaid fee-for-service and managed care programs and routinely analyze this data. HHSC should review methodologies federal government and national researchers use to estimate the amount of in-office diagnostic ancillary services provided to Medicare clients and adopt a similar methodology for quantifying the amount of these services provided to Texas Medicaid clients. At a minimum, HHSC should require that all diagnostic ancillary service claims submitted in the Medicaid fee-for-service, STAR and STAR+PLUS programs include the ordering provider's NPI.

HHSC has taken some steps to limit unnecessary diagnostic ancillary services provided to clients receiving services

FIGURE 3
STUDIES ON THE IMPACT OF IN-OFFICE DIAGNOSTIC ANCILLARY SERVICES, 2009 TO 2012

RESEARCH ENTITY	DATE	DESCRIPTION	FINDINGS
Georgetown University	2012	The study analyzed Medicare claims and beneficiary summary files to examine the effects of self-referral on the use of surgical pathology services and related cancer detection rates associated with prostate biopsies. In a self-referral arrangement, a urology practice bills Medicare for both the biopsy and the related surgical pathology services.	The study concluded that the self-referral of prostate surgical pathology services leads to increased use and higher Medicare spending, but lower cancer detection rates. Specifically: • On average, self-referring urologists billed Medicare for 4.3 more surgical pathology jars per biopsy than the adjusted mean of six jars that non-self-referring urologists sent to independent pathology providers—a difference of almost 72 percent. Self-referring urologists may be extracting a greater number of tissue cores or they may be separating the tissue cores into a greater number of jars than non-self-referring urologists. Medicare reimburses each pathology provider for the number of jars that contain tissue cores. • The prostate cancer detection rate for men whose biopsies were performed by self-referring urologists was 8.3 percentage points lower than the rate for men treated by non-self-referring physicians.
American College of Radiology	2010	The study analyzed Medicare claims data to examine whether patients treated by physicians who provided in-office imaging services (i.e., CT, MRI, nuclear medicine procedures, ultrasound, and x-rays) have, on average, shorter care episodes and costs that are no higher than costs incurred by patients treated by physicians who do not self-refer. The study controlled for differences that might be attributed to patients' age, health status, or severity of illness, to the specialty of the physicians, or to the geographic locale of care.	The study concluded that in-office imaging is associated with significantly and substantially higher total care costs in the majority of medical conditions and imaging types examined. The study also found that in-office imaging is not associated with shorter illnesses, except with x-rays for some conditions.
Stanford University	2010	The study analyzed Medicare claims data to examine the association between physician acquisition of MRI equipment, use of MRI by patients, and healthcare spending. The analysis focused on before and after comparisons of MRI use by patients of orthopedic surgeons and neurologists who began billing for MRIs. The study findings are adjusted for time trends, physician characteristics, and patient case-mix.	The study concluded that physicians ordered significantly more MRI procedures after they began billing for them, but the portion of the increase attributed to physicians' acquisition of equipment is limited. The study also found that beginning to bill for MRIs was associated with an increase in physician and outpatient spending.
American College of Radiology	2010	The study analyzed Medicare claims data to determine the percentage of in-office imaging services that were accompanied by a same-day office visit to the same physician. The study defined in-office imaging to include procedures where the claims had the same unique provider identification number in both the referring physician and the performing physician fields.	The study found that, except for chest and musculoskeletal x-rays, same-day imaging was the exception. Specifically, the study found that 21.2 percent of in-office imaging other than chest and musculoskeletal x-rays, which represents 71.8 percent of total in-office imaging, had an office visit on the same day. In contrast, 73.9 percent of chest and musculoskeletal x-rays, which represent 28.2 percent of in-office imaging, had an office visit on the same day.
Medicare Payment Advisory Commission	2009	The study analyzed Medicare claims data to examine whether physician self-referral for imaging services is related to higher use of imaging by type of clinical episode. The study also examined whether greater use of imaging within an episode of care is associated with higher or lower total episode spending. The study defined a physician as self-referring if more than 50 percent of imaging studies ordered by the physician are performed by his or her practice.	The study found that episodes of care with a self-referring physician are associated with greater imaging spending than episodes with no self-referring physician. The study's findings also support the hypothesis that, on average, higher spending on imaging within an episode of care is associated with higher overall spending during the episode and does not result in net savings. The findings controlled for differences in patients' clinical conditions and illness severity, physician specialty, and geographic market area.

SOURCE: Legislative Budget Board.

through the Texas Medicaid fee-for-service program. Similarly, some of the MCOs participating in the STAR or STAR+PLUS programs have implemented strategies to limit unnecessary diagnostic ancillary services among clients enrolled in their health plans. However, these efforts are not uniformly implemented across the Texas Medicaid program and may be insufficient to ensure appropriate use of these services, particularly in-office diagnostic ancillary services. **Figure 4** describes the strategies implemented in the program to limit unnecessary diagnostic ancillary services.

Recommendation 2 would amend the Texas Government Code to direct HHSC to strengthen existing methods used to limit unnecessary diagnostic ancillary services and adopt new cost-effective strategies to ensure appropriate use of these services in the Texas Medicaid fee-for-service and managed care programs, including steps to improve payment accuracy for diagnostic ancillary services. Since in-office diagnostic ancillary services are a subset of the broader category of diagnostic ancillary services, efforts to ensure appropriate use of diagnostic ancillary services in general should also help reduce unnecessary in-office services. However, it may be helpful to place additional focus specifically on reducing unnecessary in-office diagnostic ancillary services. HHSC should examine establishing a prior notification program and modifying the prior authorization program when it considers both modifications to existing methods and the adoption of new cost-effective strategies.

Establishing a prior notification program in the Texas Medicaid fee-for-service program is one option for HHSC to consider. This program would compare outlier physicians' use of diagnostic ancillary services to evidence-based clinical guidelines and educate physicians about the appropriate use of diagnostic ancillary services. HHSC should also consider requiring that all STAR and STAR+PLUS MCOs implement a similar program.

Modifying the prior authorization program in the Texas Medicaid fee-for-service program is another option for HHSC to consider. Program modifications should ensure that the program targets providers who order significantly more diagnostic ancillary services than their peers who treat similar patients. Outlier physicians who order diagnostic

FIGURE 4
STRATEGIES IMPLEMENTED IN THE TEXAS MEDICAID PROGRAM TO LIMIT UNNECESSARY DIAGNOSTIC ANCILLARY SERVICES, FISCAL YEAR 2013

PROGRAM	STRATEGY
Fee-For-Service:	• HHSC requires that all Magnetic Resonance Imaging, Magnetic Resonance Angiography, Computed Tomography Imaging, and Computed Tomography Angiography services not rendered in an emergency or inpatient setting be prior authorized through MedSolutions. MedSolutions operates a Medicaid radiology benefits management program where it determines whether certain radiological services are medically necessary. • The Medicaid Management Information System (MMIS) claims processing subsystem, operated by the Texas Medicaid and Healthcare Partnership, includes prepayment editing designed to ensure proper payment of some laboratory and radiology services. Prepayment system edits that may help identify unnecessary ancillary services include: 1) edits that ensure a specific medical diagnosis is submitted to help ensure that the tests are only ordered for conditions that are clinically indicated; 2) edits that ensure that services are not unbundled for additional payment; 3) edits that identify multiples of the same test on the same day without supplying medical documentation. • Starting in fiscal year 2013, the HHSC Office of Inspector General plans to conduct medical necessity investigations of providers who are identified as high users of certain ancillary services.
STAR and STAR+PLUS:	• Pre-authorization for designated diagnostic ancillary services or for services ordered by providers who have billing patterns outside the normal range. • Contracting with an Imaging Benefits Manager that may or may not include an extra focus on physicians performing in-office ancillary services. • Prepayment claims editing software that helps identify unnecessary ancillary services, including edits that identify a comparatively higher number of a particular service by a provider when compared to similar providers in geographic area. These edits can result in denied claims pending the receipt of records. • Direct consultation with or investigation of physicians with ancillary service billing patterns that are outside the expected range based on retrospective review of claims data or claims auditing.

Note: Not all strategies listed under the STAR and STAR+PLUS delivery model have been implemented by all MCOs participating in the STAR and STAR+PLUS programs.
Source: Legislative Budget Board.

ancillary services inappropriately should be required to participate in a prior authorization program where service requests are reviewed and approved before they are provided. HHSC should consider expanding prior authorization to additional types of diagnostic ancillary services that account for a significant share of spending, have evidence-based standards for appropriate use, and exhibit variations in utilization among providers and geographic areas. HHSC should also consider requiring similar modifications to prior authorization programs operated by STAR and STAR+PLUS MCOs, and should consider requiring that all STAR and STAR+PLUS MCOs implement a prior authorization program.

HHSC should also examine options to improve payment accuracy for diagnostic ancillary services and reduce the financial incentive for self-referring providers to order unnecessary diagnostic ancillary services.

The first option to address payment accuracy would be accounting for duplications in physician work and practice expense that occur when two or more diagnostic ancillary services are provided at the same time. For example, when a physician performs the professional component of two MRI studies during the same encounter, certain activities, such as reviewing the patient's records and discussing the findings with the referring physician, are likely to occur only once. Options may include: (1) combining into a single payment rate, or comprehensive code, multiple discrete ancillary services often furnished together during the same encounter by the same provider; or (2) reducing the payment rate for the second and subsequent ancillary services performed on the same patient in the same session by the same provider. These options should be considered in the Texas Medicaid fee-for-service program as well as STAR and STAR+PLUS.

The second option to address payment accuracy that HHSC should consider would be reducing payment rates in the Texas Medicaid fee-for-service program for certain diagnostic ancillary services ordered and performed by the same provider. It may be appropriate to remove duplicate activities from the payment rate for ancillary services that are ordered and performed by the same provider. For example, the payment for a diagnostic ancillary service may include post-service activities, such as discussing the findings with the referring physician. This activity is unnecessary when the referring and performing physician is the same provider. HHSC should also consider requiring a similar payment rate reduction in the STAR and STAR+PLUS programs.

HHSC should review the strategies MedPAC recommended in fiscal year 2011 to reduce unnecessary diagnostic ancillary services in Medicare and consider adopting these strategies in the Texas Medicaid program. The agency should also identify existing cost-effective strategies used by STAR and STAR+PLUS MCOs to reduce unnecessary diagnostic ancillary services and consider implementing these strategies in fee-for-service Medicaid, and require their use by other STAR and STAR+PLUS MCOs.

Recommendation 3 would include a rider in the introduced 2014–15 General Appropriations Bill that would require HHSC to submit a report on in-office diagnostic ancillary service use in the Texas Medicaid program, including strategies the agency implements to reduce unnecessary diagnostic ancillary services, to the Legislative Budget Board and the Office of the Governor by December 1, 2014.

FISCAL IMPACT OF THE RECOMMENDATIONS

The recommendations in this report direct HHSC to take steps to reduce unnecessary in-office diagnostic ancillary services in the Texas Medicaid program. It is estimated that the recommendations would have no significant fiscal impact.

Recommendation 1 directs HHSC to collect data necessary to allow it to quantify the amount of in-office diagnostic ancillary services provided to clients in the Texas Medicaid fee-for-service and managed care programs, and routinely analyze this data. The Texas Medicaid claims processing system for the Texas Medicaid fee-for-service program as well as most of the claim processing systems operated by the STAR and STAR+PLUS MCOs already include a field that would allow for the calculation of a portion of the amount spent on in-office diagnostic ancillary services. HHSC only needs to require that all diagnostic ancillary service claims include the ordering provider's NPI. The implementation of this requirement in the Texas Medicaid program as well as the analysis of ancillary service data could be implemented using existing agency resources.

Recommendation 2 directs HHSC to strengthen existing methods used to limit unnecessary diagnostic ancillary services and adopt new cost-effective strategies to ensure appropriate use of these services in the Texas Medicaid fee-for-service and managed care programs, including steps to improve payment accuracy for diagnostic ancillary services. Any modifications to existing methods or new strategies HHSC implements should only include cost-effective components and thus, the cost of any changes should be

offset by reductions in unnecessary diagnostic ancillary services. To the extent that HHSC implements strategies that reduce unnecessary diagnostic ancillary services, the recommendation should result in savings in the Texas Medicaid program.

Recommendation 3 directs HHSC to submit a report on in-office diagnostic ancillary service use in the Texas Medicaid program, including strategies implemented by the agency to reduce unnecessary diagnostic ancillary services to the Legislative Budget Board and the Office of the Governor by December 1, 2014. This recommendation could be implemented using existing agency resources.

The introduced 2014–15 General Appropriations Bill includes a rider to implement Recommendations 1 and 3.

INCREASE FOOD SECURITY BY IMPROVING THE CONSISTENCY OF SUPPLEMENTAL NUTRITION ASSISTANCE PROGRAM ELIGIBILITY POLICIES

The Supplemental Nutrition Assistance Program, formerly known as the Food Stamps Program, is a state-administered federal program that provides low-income recipients with money to purchase food. Texas disqualifies an entire household from receiving program benefits if the primary wage earner does not comply with employment and training requirements. The state also bans potential participants with certain felony drug convictions from the program for life. These two policies create inconsistencies within the program. They also limit access to program benefits for household members who would otherwise be eligible, thus increasing their risk of food insecurity. Food insecurity has been associated with poorer health outcomes and academic performance in children. Amending these policies would increase the consistency of program administration and reduce food insecurity for tens of thousands of Texans. Changing these policies could be done at no additional cost to the state and would increase the flow of federal funds into the Texas economy.

FACTS AND FINDINGS

- ♦ According to the Economic Research Service of the United States Department of Agriculture, Texas had the second highest prevalence of food insecurity in the country from 2008 to 2010, averaging 18.8 percent of households. The national average during the same period was 14.6 percent.
- ♦ Texas is one of only three states that deny benefits to an entire household, including children, when the primary wage earner does not comply with employment and training requirements in the Supplemental Nutrition Assistance Program. Other states sanction the individual but not the entire family.
- ♦ Texas is one of a minority of states that has not lifted or modified a lifetime federal ban on participation by those with a felony drug-related conviction after 1996. Participants with other felony convictions, such as theft and murder, are not banned from the program.
- ♦ Many people with drug felonies have to submit to drug testing as a condition of their probation or parole. A separate federal law states that any individual who is in violation of the terms of their probation or parole is ineligible for SNAP.

CONCERN

- ♦ Texas Supplemental Nutrition Assistance Program policies prevent certain low-income children and adults from accessing food assistance, even though they meet income eligibility criteria and comply with the behavioral requirements of the program. This increases their risk for food insecurity and is inconsistent with the way other participants in the program are treated.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Amend statute to require the Health and Human Services Commission to impose only an individual, instead of household, disqualification when the primary wage earner in a household receiving Supplemental Nutrition Assistance Program benefits fails to comply with employment and training requirements.
- ♦ **Recommendation 2:** Amend statute to prevent the disqualification of otherwise eligible individuals from receiving Supplemental Nutrition Assistance Program benefits due only to having a felony drug conviction.

DISCUSSION

According to the Economic Research Service of the United States Department of Agriculture (USDA),Texas had the second highest prevalence of food insecurity by household in the country, averaging 18.8 percent of all households, from 2008 to 2010. The national average was 14.6 percent during the same period. For low-income households, the prevalence of food insecurity is higher: nationally, 37.6 percent of households with incomes below 130 percent of the federal poverty level suffer from food insecurity, as do 41.9 percent of households at that income level that include children.

Households are considered food secure by the USDA only if they consistently have access to enough food to lead active, healthy lives. According to a study by medical researchers, published in the Journal of Nutrition in 2004, young children who experience food insecurity are more likely to suffer poor health and are at higher risk for hospitalization

than children who get enough to eat, even when accounting for poverty levels. Another study published in the Journal of Nutrition in 2005 found that food insecurity at kindergarten predicted impaired academic performance in reading and mathematics for boys and girls. Some families living in poverty may not have enough resources to purchase enough food or maintain a nutritionally adequate diet. The Supplemental Nutrition Assistance Program (SNAP), formerly called the Food Stamp Program, is a federally funded program that provides recipients with additional money to purchase food. The federal Food Stamp Act of 1964, which established the permanent Food Stamp Program, was intended to improve the nutrition of low-income Americans and strengthen the nation's agricultural economy. Over time, both states and the federal government changed eligibility, benefit, and penalty policies for the program.

In Texas, an entire household is disqualified if the primary wage earner does not comply with employment and training requirements, and potential participants with felony drug convictions are banned from the program for life. These two policies limit access to SNAP benefits for household members that would otherwise be eligible, such as dependent children, thus contributing to a higher rate of food insecurity in the state. Amending these policies could reduce the rate of food insecurity in Texas.

SNAP ADMINISTRATION AND FUNDING

SNAP monetary benefits are 100 percent federally funded, while a state and the federal government each pay half of administrative costs. Given this shared administration, the federal government sets certain guidelines, but also allows each state options for determining eligibility and benefits, resulting in different rules for SNAP programs among the states. In Texas, the Health and Human Services Commission (HHSC) administers SNAP eligibility.

To continue receiving benefits, certain recipients must either work at least 30 hours per week or register to participate in SNAP Employment and Training (E&T) activities that are intended to help participants become self-sufficient. These activities are coordinated by the Texas Workforce Commission and administered by Local Workforce Development Boards.

SNAP E&T funding is structured differently than the program's food benefits, and is comprised of three primary funding sources:

1. 100 percent federal grant for general services: The Food and Nutrition Service (FNS), part of the U.S. Department of Agriculture (USDA), provides grant funds to cover approved direct SNAP E&T activities, such as job searching, education, and training as well as administrative operations of the program. Grant funding excludes other support services, such as transportation cost reimbursement. This funding is distributed among states through a formula.
2. 50 percent state General Revenue Funds and 50 percent matching Federal Funds: FNS also provides matching funds depending on what states appropriate to supplement the 100 percent Federal Funds. These funds may be used for approved direct SNAP E&T activities and for support and job retention services, including transportation.
3. 100 percent Federal Funds to serve able-bodied adults without dependents (ABAWDs): These funds serve only ABAWDs and are only for approved direct SNAP E&T services, not support services such as transportation. Texas receives these funds because it has pledged to serve all "at risk" ABAWDs who are not living in exempt counties or part of a 15 percent exemption. These funds are allocated among all pledge states according to a formula distribution.

ELIMINATING THE HOUSEHOLD SANCTION FOR NON-COMPLIANCE WITH EMPLOYMENT AND TRAINING REQUIREMENTS

SNAP household members age 16 to 59 who work fewer than 30 hours per week must register for E&T services. These mandatory work registrants may be exempt from participating in services for various reasons, such as attending school, caring for children under age six, or being at least three months pregnant.

Mandatory work registrants age 18 to 49 who have no dependents are classified as ABAWDs. ABAWDs can receive SNAP benefits for only three months out of a 36-month period unless they are employed at least 20 hours per week or participate in SNAP E&T for at least an average of 30 hours per week. Mandatory work registrants who are not ABAWDs are considered SNAP E&T general population.

Unlike SNAP food benefits, SNAP E&T services are not an entitlement, therefore services to the SNAP general population are provided only if funding is available. Current funding cannot support SNAP E&T activities for all eligible work registrants. Some counties are considered full-service counties, where all ABAWDs are served and mandatory work

registrants are sanctioned with denial of benefits for not complying with requirements. Other counties are considered minimum-service counties, where SNAP E&T activities are voluntary and offered only as funding allows. During fiscal year 2012, 172 full-service counties and 82 minimum-service counties operated in Texas.

In addition to the previously mentioned reasons for exemption from SNAP E&T participation, other work registrants may not be penalized for failing to participate in E&T programs. Personal circumstances or crisis if the reason is considered "good cause" can exempt registrants from the requirement. Good causes can include temporary illness, absences for required court appearances, or caring for a disabled household member. However, if a registrant lives in a full service county, is required to participate in E&T, and refuses without "good cause", that person is denied benefits. If that person is the household's primary wage earner, the entire household is denied benefits for a penalty period. The penalty period is one month for the first occurrence, three months for the second occurrence, and six months for the third or subsequent occurrences, or until the person complies, whichever is longer.

Texas is one of three states that denies benefits to the entire household if the primary wage earner is non-compliant; other states disqualify only the non-compliant individual. Children in households with non-compliant primary wage earners may not be able to control the behavior of the adults. This situation may increase their risk of food insecurity if they are no longer receiving food assistance. The consequences for non-compliance by the primary wage earner differ from the consequences for non-compliance by any other household member. The Texas Administrative Code, Section 372.1352(a)(2), states that if the non-compliant household member is not the primary wage earner, then only the individual is disqualified for a penalty period, not the entire household.

If the state adopted a policy of individual disqualification, instead of household disqualification, dependent children and other household members could continue to receive food assistance while the primary wage earner's benefits are denied. The household's benefits would be calculated by using the total income of the household, but the size of the household would exclude the disqualified member, a calculation SNAP uses in other benefit administration areas. **Figure 1** shows the maximum monthly household allotments for Texas and most other states based on household size.

FIGURE 1
MAXIMUM MONTHLY SNAP ALLOTMENT, OCTOBER 2011 TO SEPTEMBER 2012

HOUSEHOLD SIZE	MAXIMUM ALLOTMENT
1	$200
2	$367
3	$526
4	$668
5	$793
6	$952
7	$1,052
8	$1,202
For each additional person, add:	$150

Source: United States Department of Agriculture, Food and Nutrition Service.

Actual allotments may be lower, as they depend on the household's income and expenses.

Figure 2 shows the effects of the current policy, including the number of cases subject to E&T requirements that include children, the number of cases denied the following month for non-compliance with E&T requirements, and the amount of benefits denied. The number and percentage of cases denied for non-compliance has decreased during this period, while overall caseloads have increased.

Recommendation 1 would amend the Texas Human Resources Code, Chapter 33, to require HHSC to impose an individual disqualification instead of household disqualification when the primary wage earner in a household receiving SNAP benefits fails to comply with employment and training requirements. This change would increase the program's internal consistency by treating all non-compliant individuals equally. It would also reduce the risk of food insecurity for other compliant participants in a household headed by a non-compliant person.

If the state had eliminated the household disqualification in fiscal year 2007, more SNAP funds would have been distributed to Texas families. **Figure 3** provides an estimate of the additional SNAP funds families would have received in this alternative scenario, based only on households that included children. Other households that include disabled adults or elderly members are not included in this table. The estimate assumes the average household's benefit before disqualification would be reduced by $159, which is the difference between the maximum for a three-person

FIGURE 2
CURRENT POLICY OF DISQUALIFYING ENTIRE HOUSEHOLD, FISCAL YEARS 2007 TO 2011

FISCAL YEAR	HOUSEHOLDS SUBJECT TO E&T, WITH CHILDREN, MONTHLY AVERAGE	HOUSEHOLDS DENIED FOLLOWING MONTH, AVERAGE	AVERAGE HOUSEHOLD MONTHLY BENEFITS DENIED	TOTAL AVERAGE HOUSEHOLD BENEFITS DENIED MONTHLY	PERCENTAGE OF E&T CASES WITH CHILDREN DENIED
2007	99,222	2,260	$378	$853,940	2.28%
2008	95,909	1,472	$391	$576,165	1.53%
2009	120,783	652	$432	$281,447	0.54%
2010	149,358	582	$475	$276,468	0.39%
2011*	188,349	872	$479	$417,581	0.46%

*Fiscal year 2011 averages exclude June to August data, the period when Texas Integrated Eligibility Redesign System (TIERS) was implemented statewide. TIERS data pertaining to transactions is not fully available at this time.
Source: Health and Human Services Commission.

FIGURE 3
ALTERNATIVE POLICY SCENARIO--DISQUALIFY PRIMARY WAGE EARNER ONLY, FISCAL YEARS 2007 TO 2011

FISCAL YEAR	HOUSEHOLDS SUBJECT TO E&T,* WITH CHILDREN, MONTHLY AVERAGE	PWE DENIED FOLLOWING MONTH, AVERAGE	BENEFIT DENIED TO PWE,* MONTHLY AVERAGE	BENEFIT RECEIVED FOR DEPENDENTS, MONTHLY, AVERAGE	TOTAL BENEFITS DENIED MONTHLY, AVERAGE	TOTAL BENEFITS RECEIVED FOR DEPENDENTS MONTHLY
2007	99,222	2,260	$159	$219	$359,380	$494,560
2008	95,909	1,472	$159	$232	$234,008	$342,157
2009	120,783	652	$159	$273	$103,655	$177,792
2010	149,358	582	$159	$316	$92,472	$183,996
2011**	188,349	872	$159	$320	$138,666	$278,915

*E&T= Employment and Training; PWE= Primary Wage Earner.
**Fiscal year 2011 averages exclude data from June to August. This omission was when Texas Integrated Eligibility Redesign System (TIERS) was implemented statewide. TIERS data pertaining to transactions is not fully available at this time.
Source: Legislative Budget Board.

household and a two-person household. Actual amounts would have varied by household.

SNAP benefits can be spent only on food, which is usually not taxable. However, some families may use SNAP benefits in place of the money they were using to purchase food. In such a case, households may shift to using some money previously spent on food to now pay for other expenses that are subject to the sales tax. Therefore, the state would likely see a small increase in sales tax revenue based on the increased purchasing power of these households. For example, in fiscal year 2011, Texas families with children would have received an additional $3.3 million ($278,915 per month) in SNAP benefits had this policy change been in effect. Based on an analysis of national consumption surveys, approximately 30 percent of household spending is allocated to taxable goods. If these previously excluded households shifted $0.30 of their own money for every dollar of SNAP benefits they received from non-taxable to taxable goods during fiscal year 2011, the state would have gained an additional $62,756 in sales tax revenue. Local governments could have received an additional $20,082. These figures would be higher if households with elderly or adult dependents were included.

LIFTING THE BAN ON INDIVIDUALS WITH FELONY DRUG CONVICTIONS

The federal Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) prohibited any individual convicted under federal or state law of a felony offense occurring after August 22, 1996, involving the possession, use, or distribution of a controlled substance from receiving certain public benefits, including food stamps. The ban on individuals with felony drug convictions increases the risk of food insecurity for Texans who would otherwise be eligible for benefits. Children from households headed by parents excluded from SNAP benefits for life receive less food assistance than if the parents were eligible because the countable household size is smaller. **Figure 1** shows the

maximum allotment by household size. These children may be placed at higher risk for food insecurity. Those adults who are reintegrating into society after incarceration may benefit from the support of food assistance and E&T activities. They often face additional barriers to employment because of their felony convictions. These supports are available to other people with felony convictions, and may help reduce recidivism and its related costs.

PRWORA gave states the option to lift or modify the ban on those with felony drug convictions through legislative action. Recommendation 2 would amend Chapter 33 of the Texas Human Resources Code to require HHSC to prevent disqualification of otherwise eligible individuals from receiving SNAP benefits solely due to a felony drug conviction. No other offenses, such as theft, assault, or murder, are subject to the same lifetime ban. A separate federal law states that any fleeing felon or individual who is in violation of the terms of probation or parole is ineligible for SNAP, so Recommendation 2 would not reward those ex-offenders who are not complying with their requirements, and it may give individuals more of an incentive to successfully complete their supervision. The ban on individuals with felony drug convictions who completed their sentences or who are not in violation of their supervision requirements is inconsistent with the treatment of other individuals with criminal convictions in the program. SNAP benefits are also available to those who are attending drug or alcohol rehabilitation treatment programs, if they are not excluded because of a felony conviction, thereby reflecting another inconsistency in program policy that Recommendation 2 would address.

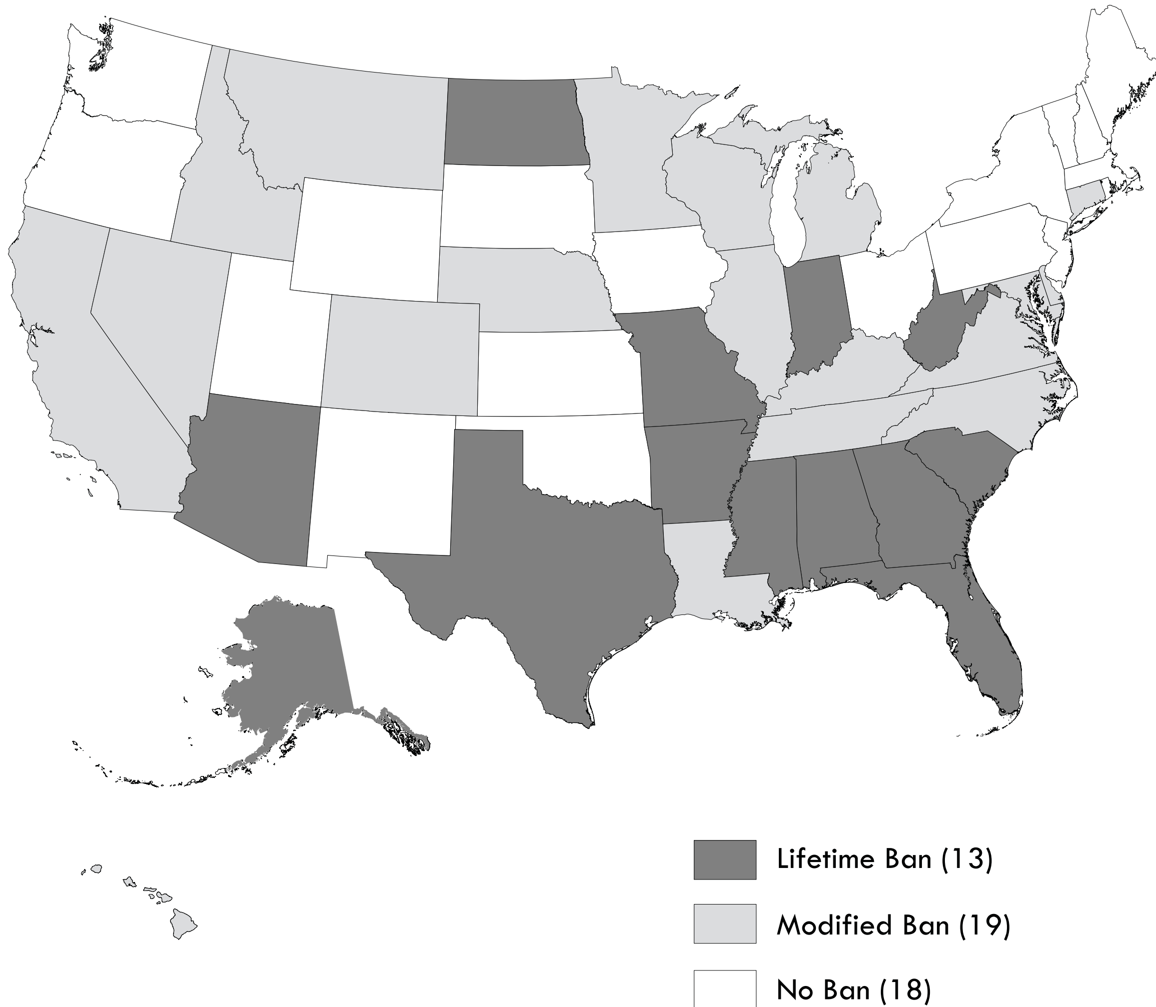
According to the USDA, 13 states, including Texas, have neither lifted nor modified the ban. **Figure 4** shows the states that have lifted or modified this law.

While states have chosen different methods of modifying the federal ban, Recommendation 2 proposes lifting the ban. Applying the ban to a narrower type of conviction or delaying eligibility maintains inconsistent rules for different types of ex-offenders and keeps these adults and their children at elevated risk for food insecurity. Some states allow only those who are in treatment or who have completed drug treatment programs to receive benefits, but this disadvantages those who are unable to pay for treatment or obtain services through public assistance. Also, that exemption would not benefit those who either never had a substance abuse disorder or those who stopped using drugs without attending a formal drug treatment program. Requiring drug testing for any applicant with a drug-related conviction would increase the program's administrative costs and slow application processing. Drug testing is already a component of supervision programs, which most drug felons are assigned to as part of their adjudication. Judges may require many of these individuals to participate in treatment programs or submit to drug testing as part of their probation. Parole panels are required to impose testing for controlled substances in cases where drug use was related to the offender's conviction. Therefore, by complying with the conditions of their probation or parole, many individuals with drug convictions are already being drug-tested. In these instances, adding a second requirement for eligibility processing would be redundant.

Lifting the ban on participants with felony drug convictions would expand SNAP eligibility. However, estimating the number of additional people who may be eligible for SNAP benefits is challenging. First, data gaps prevent the precise estimation of the number of residents who have accrued felony drug convictions since 1996. For example, there is no mechanism for tracking the movement of people with felony drug convictions in and out of state once they complete their sentences and supervision. Second, individual level data is not collected on income, expenses, and household size, which would be necessary to determine eligibility for those who were no longer banned from SNAP eligibility. According to a 2005 report from the Government Accountability Office (GAO), based on data from 2001, an estimated 23 percent of drug offenders released from prison were the parents of minor children whose incomes were below the federal poverty guidelines. GAO researchers were unable to estimate the percentage of drug offenders that could be eligible to receive food stamps as ABAWDs. Finally, it is assumed based on available studies that only a portion of those ex-offenders who are eligible would choose to apply for SNAP benefits. According to the Food and Nutrition Service of the USDA, approximately 62 percent of all persons eligible for SNAP benefits in Texas participated in the program during 2009, the most recent year for which data is available.

While these data limitations should be acknowledged, some estimate of the number of people with felony drug convictions is possible. To estimate a minimum, HHSC has data on households with active cases that include children, and in which at least one household member is disqualified due to a felony drug conviction, as shown in **Figure 5**. For these cases, the disqualified household members would become

FIGURE 4
STATUS OF BAN ON SNAP BENEFITS FOR INDIVIDUALS WITH DRUG FELONIES, 2010



NOTE: For offenses after August 22, 1996.
SOURCE: National Conference of State Legislatures.

FIGURE 5
TEXAS SNAP CASES CONTAINING DISQUALIFIED MEMBER(S) AND CHILDREN, FISCAL YEARS 2007 TO 2011

FISCAL YEAR	DRUG DISQUALIFICATION CASES WITH CHILDREN, MONTHLY AVERAGE	PERCENTAGE OF ALL CASES	AVERAGE MONTHLY CASELOAD
2007	6,244	0.69%	910,656
2008	6,809	0.73%	928,100
2009	8,517	0.78%	1,097,902
2010	10,525	0.83%	1,269,766
2011	12,139	0.84%	1,444,924

SOURCE: Health and Human Services Commission.

eligible, but overall SNAP caseloads would not change because these are already active cases.

Other households may have applied and been denied because the household's income was too high for the household size excluding the member with the drug conviction, but the household may meet the income eligibility guidelines if that member were included in the calculation.

An upper limit of the potential size of the expanded population could be estimated with a count of all persons in the state who had a felony drug conviction after August 22, 1996 and are not incarcerated. TDCJ estimates this number to be approximately 212,000 persons as of April 2012, though this number only includes certain offenders. Each year there would be additional offenders who would become part of this population. From fiscal years 2007 to 2011, an average of about 11,800 offenders have been admitted per year by TDCJ for drug convictions with no previous drug conviction sentences to TDCJ. Variations in sentence length could cause differences in number of individuals released back into the community each year, but this provides some estimate of the growth in this population.

If participants with felony drug convictions became eligible to receive benefits, they would also become subject to the program's E&T requirements. Some would be considered SNAP general population, and others would be considered ABAWDs. ABAWDs may receive benefits only for three out of 36 months without participating in E&T activities or working, unless they either live in a waiver county or are part of the state's allowed 15 percent exemption. The state has pledged to serve all non-exempt ABAWDs who are "at-risk," meaning that they are in the last month of the three-month limit, do not reside in a waiver county, and are not part of the 15 percent exemption group. The state is not required to exempt the full 15 percent, and it can carry over any unused exemptions for future use. Through the end of fiscal year 2010, Texas carried over 867,147 exemptions, and added 128,652 for 2011, resulting in 995,799 exemptions available for use. Other populations are only served as funding is available. Therefore, the state would not be required to increase funding to cover new E&T participants unless federal funding did not increase sufficiently, and the state depleted its exemptions while still being required to serve more ABAWDs.

FISCAL IMPACT OF THE RECOMMENDATIONS

The recommendations would have no direct fiscal impact on appropriations of General Revenue Funds during the 2014–15 biennium; however, they would increase the flow of federal SNAP food benefits to Texans currently excluded from the program. As federal funds enter the Texas economy and families shift some of their available personal income from food to other, taxable goods, the state could realize marginal increases in both state and local sales tax revenue.

Implementation of Recommendations 1 and 2 could increase household applications for SNAP benefits. However, some of these eligibility determinations may occur regardless of the proposed program changes as part of continued implementation and use of the Texas Integrated Eligibility Redesign System to process state applications for other programs such as Medicaid or Temporary Assistance for Needy Families. This analysis assumes Recommendations 1 and 2 could be implemented by using existing agency resources at no significant additional cost to the state.

Recommendations 1 and 2 would also streamline administrative processes. HHSC indicated that Recommendation 1 would not add administrative complexity, and that it may reduce the workload for assigning, tracking, and clearing sanctions. Recommendation 2 would allow HHSC to process SNAP eligibility applications more quickly. The agency estimated that eliminating the check for drug felony status would save enough time on each application to reduce current staffing levels by seven full-time-equivalent positions statewide, allowing the agency to reallocate the employees' time to increases in the number of other types of applications. Given the reduced time per application, it is anticipated that HHSC could absorb the slight increase in applications by using existing resources.

Recommendation 2 is not estimated to increase SNAP E&T costs, because some increase in ABAWDs could be served with funds now used for SNAP general population, and additional capacity exists for exempting ABAWDs from participation if necessary.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

AUTHORIZE COUNTIES TO FUND MEDICAID COVERAGE FOR NEWLY ELIGIBLE ADULTS WITH LOCAL REVENUE

Most Texas hospitals provide health services free of charge (i.e., charity care) to individuals who meet certain financial criteria. Uncompensated care provided by 535 hospitals in fiscal year 2011 totaled approximately $3.1 billion. Some portion of this uncompensated care is spent on services provided to persons who may be eligible for health insurance coverage through Medicaid expansion. Beginning in January 2014, the provisions of the Affordable Care Act of 2010 will provide an enhanced federal match for states to provide Medicaid coverage of adults with income below 133 percent of poverty (increases to 138 percent with the allowable 5 percentage point exclusion of income). In calendar years 2014 to 2016, the federal match for services for these adults is 100 percent, decreasing to 90 percent by calendar years 2020 and beyond. Administrative costs for program support will remain at a 50 percent federal match for all years. A potential source of matching funds for a Medicaid expansion is local healthcare dollars, including local revenue devoted to public hospitals and hospital districts. In the 2014–15 biennium when the federal match for services is 100 percent, local revenues could be used to provide the non-federal share of Medicaid administration for the newly eligible population. In subsequent years as the federal match gradually decreases, local revenues could also be used to provide the non-federal match for Medicaid services.

Of the 535 hospitals in Texas, 108 hospitals owned by city, county or hospital districts accounted for 48 percent ($1.5 billion) of charity care spending reported in fiscal year 2011. Most of the charity care (94 percent) local public hospitals provided was attributable to six hospital districts—Bexar, Dallas, El Paso, Harris, Tarrant, and Travis. Local public hospitals that account for a significant amount of uncompensated care spending report that 90.8 percent of patients receiving some form of charity care were non-elderly adults. With certain exceptions, federal law allows states to use intergovernmental transfers to obtain funds for use as the non-federal share for Medicaid services. By using local funds as the non-federal share for expanding Medicaid to the newly eligible population, Texas could generate an estimated additional $2.5 billion in Federal Funds for fiscal years 2014 and 2015.

CONCERNS

- According to 2011 data from the U.S. Census Bureau, 6.1 million Texans, approximately 24 percent of the state's population, lack health insurance. Half of the uninsured Texans under age 65 reside in six counties (Bexar, Dallas, El Paso, Harris, Tarrant, and Travis).
- Since the national pool of Disproportionate Share Hospital federal funding will be reduced beginning in fiscal year 2014, the amount allocated to Texas may still decrease even if high-uncompensated care costs remain due to the state electing not to expand Medicaid to new eligible populations authorized by the Affordable Care Act.
- Texas counties use a significant amount of local funds to provide healthcare to the uninsured population that could be leveraged as matching federal funds for Medicaid.

RECOMMENDATIONS

- **Recommendation 1:** Amend statute to authorize intergovernmental transfers from counties to finance the option to expand Medicaid to 138 percent of the federal poverty level to reduce the number of uninsured Texans.
- **Recommendation 2:** Amend statute to direct the Health and Human Services Commission to either amend the Medicaid State Plan or to submit a Section 1115 Waiver that would authorize counties to expand Medicaid to 138 percent of the federal poverty level.
- **Recommendation 3:** Amend statute to require the Health and Human Services Commission to promulgate eligibility standards and requirements for counties expanding Medicaid.

DISCUSSION

Medicaid is a joint federal-state partnership for providing medical care to low-income individuals. Federal law requires that states participating in Medicaid provide basic healthcare for certain low-income residents and people with chronic or long-term care needs. States may elect to provide certain additional services or serve expanded populations in their

Medicaid program beyond what is required by federal law. Medicaid is administered by the Health and Human Services Commission (HHSC) in Texas. While the Texas Medicaid program serves various client groups and covers many different medical and long-term care services, there are three general categories of persons eligible for Medicaid: pregnant women and children, cash assistance recipients, and the aged and disabled. These persons must meet income eligibility requirements. While states have had the option to cover additional categories, the federal Affordable Care Act of 2010 (ACA) directed states to expand Medicaid to certain populations. Services for the newly eligible populations will be 100 percent federally funded from 2014 to 2016. Federal funding then decreases to 90 percent by 2020.

However, the U.S. Supreme Court in June 2012, ruled that the Medicaid expansion was optional for states. Even if states choose not to participate in the expansion of Medicaid, at the state level there is a potential to draw down federal funds to expand Medicaid to uninsured adults. Texas could authorize counties the option to expand Medicaid coverage to uninsured adults by using local funds as the non-federal share of the enhanced federal match. Having limited expansion of Medicaid would enable local communities to be reimbursed a significant amount of uncompensated care costs associated with uninsured adults.

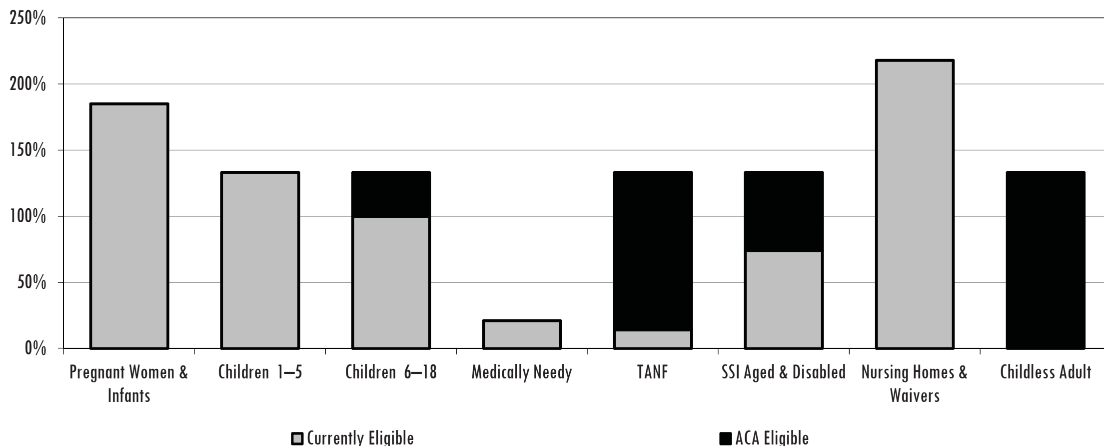
MEDICAID EXPANSION UNDER THE AFFORDABLE CARE ACT

Under the current Texas Medicaid program, if a person between the ages of 18 and 64 does not have a serious disability or is not the parent of children under age 19, he or she cannot qualify for Medicaid coverage, regardless of income. The ACA expanded Medicaid to most U.S. citizens and legal permanent resident non-citizens with income up to 133 percent of the Federal Poverty Level (FPL), who are not eligible for Medicare, starting in January 2014. The ACA allows for a five-percentage point exclusion of income, making the effective income limit 138 percent of the FPL. **Figure 1** shows the percentage of the FPL at which various categories of clients meet Medicaid eligibility.

Few non-disabled adults now qualify for Medicaid coverage, so this group comprises most of the newly eligible. Further, the expansion increases the income limit for children ages 6 to 18 from 100 percent to 133 percent of the FPL. These children are now in the Children's Health Insurance Program (CHIP), so they will move over to Medicaid. The newly eligible populations will be 100 percent federally funded from 2014 to 2016. Federal funding then decreases to 90 percent by 2020. At the same time, the federal share of funding for CHIP increases by 23 percentage points from October 2015 to September 2019.

The entitlement structure of Medicaid has raised concerns with some for its inflexibility and for the ongoing fiscal demands it places on states; those commenters view Medicaid

FIGURE 1
CURRENT AND AFFORDABLE CARE ACT MEDICAID ELIGIBILITY LEVELS IN TEXAS
FISCAL YEAR 2012



Source: Legislative Budget Board.

expansion as a significant enlargement of a flawed program. Another criticism of Medicaid expansion is the "woodwork effect," which theorizes that as widespread publicity and awareness of Medicaid availability occurs, people who would not otherwise seek coverage will enroll in the program. Not all of these enrollees would qualify as newly eligible under the Medicaid expansion. States would then face increased expenses to the extent that people qualifying for coverage under previously existing standards seek Medicaid enrollment as a result of publicity arising from expansion. However, limiting Medicaid expansions to counties that provide the non-federal share would mitigate the statewide fiscal impact.

UNINSURED POPULATION AND ACCESS TO HEALTHCARE IN TEXAS

According to 2011 data from the U.S. Census Current Population Survey, 6.1 million Texans are uninsured; at least 24 percent of the state's population lacks health insurance. The uninsured population includes persons with various family incomes. **Figure 2** shows the FPL guidelines and 138 percent of the FPL, and **Figure 3** shows the share of uninsured persons by ranges of family income in relation to FPL.

FIGURE 2
FEDERAL POVERTY LEVEL, 2011

PERSONS IN FAMILY HOUSEHOLD	100% FEDERAL POVERTY LEVEL	138% FEDERAL POVERTY LEVEL
1	$10,890	$15,028
2	$14,710	$20,300
3	$18,530	$25,571
4	$22,350	$30,843
5	$26,170	$36,115
6	$29,990	$41,386
7	$33,810	$46,658
8	$37,630	$51,929
For each additional person, add	$3,820	$5,272

Source: U.S. Department of Health and Human Services Commission.

Because uninsured people are less likely to have access to preventive care and due to federal requirements for hospitals to provide emergency care to anyone who presents, many uninsured persons rely on the hospital emergency room as their primary source of healthcare. Care delivered in this setting is typically more expensive than care delivered in a doctor's office. A federal Agency for Healthcare Research and Quality Study found that 2009 median expenses for emergency room visits were three times greater than in a doctor's office. These increased costs are borne by insured individuals as high premiums and local taxes, and by healthcare providers in the form of uncompensated care.

FIGURE 3
SHARE OF UNINSURED TEXAS POPULATION BY FEDERAL POVERTY LEVEL RANGE, 2011

FEDERAL POVERTY LEVEL	NUMBER OF UNINSURED PERSONS	PERCENTAGE OF UNINSURED PERSONS	CUMULATIVE PERCENTAGE OF UNINSURED PERSONS
Below 50%	891,615	14.7%	14.7%
50% up to 100%	1,007,532	16.6%	31.2%
100% up to 138%	784,579	12.9%	44.1%
138% up to 200%	1,124,209	18.5%	62.6%
200% up to 400%	1,596,192	26.3%	88.9%
400% or more	675,393	11.1%	100.0%
Total	**6,079,520**	**100.0%**	

Source: U.S. Census Bureau.

Provision of and funding for healthcare to the uninsured in Texas involves a combination of federal, state, and local government programs as well as the contributions of public, for-profit, and non-profit healthcare providers. Texas law identifies counties as the providers of last resort. Counties must provide healthcare to those without other means of paying for such care. The Indigent Health Care and Treatment Act of 1985 of the Texas Health and Safety Code, Chapter 61, requires counties to offer a state-mandated set of basic healthcare services to indigent residents as the payor of last resort. Residents who have private insurance, Medicaid, or another form of health insurance are not eligible. The income eligibility level is 21 percent of FPL with certain restrictions on asset values. Federal law mandates hospital-level responsibility in provision of emergency care, and state law mandates county responsibility for indigent care. However, all levels of government are involved in the financing and provision of healthcare to low-income persons and in the reimbursement of providers for the uncompensated care they deliver.

Hospital districts are special taxing districts established to provide healthcare to low-income people within the boundaries of the district. The hospital district has the

authority to impose annual property taxes within its boundaries.

Public hospitals are hospitals owned, operated, or leased by a county or municipality. Public hospital funding comes from the same sources as hospital districts; however, local tax support is not always dedicated to indigent healthcare and may compete with other county or municipal needs.

County programs differ in terms of eligibility criteria, services offered, provision of services, and total spending. These differences are responsible for a distribution of healthcare services that varies by location. Many counties that operate a County Indigent Health Care Program (CIHCP) use the 21 percent FPL eligibility standard for their programs.

Public hospitals have higher eligibility standards than CIHCP programs, and hospital districts tend to have the most generous programs in terms of eligibility criteria. The counties of Bexar, Dallas, El Paso, Harris, Tarrant, and Travis serve persons up to at least 100 percent FPL. Most districts provided services along with a portion of patient cost-sharing to at least some persons with incomes ranging from 100 percent to 250 percent FPL.

PROGRAMS TO REIMBURSE PROVIDERS FOR UNCOMPENSATED CARE

The federal government and the state of Texas established reimbursement programs to compensate hospitals for providing uncompensated care, which are shown in **Figure 4**. The federal government distributes several sources of funding to states for certain uncompensated care expenditures through the Disproportionate Share Hospital (DSH) and Section 1115 Waiver (formerly Upper-Payment Limit) programs. Texas maintains several programs to redistribute funds to counties, hospital districts, and other providers including trauma funding and tobacco funding. These programs provided $4.0 billion in reimbursement in fiscal year 2012.

Due to the expectation of significant reductions in the number of uninsured individuals resulting from the expansion of overall health insurance coverage, the ACA includes a provision to scale back DSH funding for uninsured patients. The Secretary of the U.S. Department of Health and Human Services is charged with developing a methodology that imposes the largest percentage of reductions on states that have fewer uninsured people, and hospitals with low levels of uncompensated care and low volumes of Medicaid patients. Nationwide, DSH allotments will be reduced by $0.5 billion in 2014, rising to $4.0 billion by 2020. HHSC reported Texas' federal DSH allotment in fiscal year 2012 to be approximately $1.0 billion for state and non-state hospitals. Although it is anticipated to have a substantial negative impact, the precise reduction in Texas is unknown at this time.

CHARITY CARE IN TEXAS

Most Texas hospitals provide health services free of charge (i.e., charity care) to individuals who meet certain financial criteria. Some portion of this uncompensated care is spent on services provided to persons who could potentially be covered through a Medicaid expansion. A possible source of matching funds for a Medicaid expansion is local healthcare dollars, including hospital district tax revenue.

State law requires the Texas Department State Health Services (DSHS) to collect aggregate financial, utilization, and other data from all licensed hospitals. Through the 2011 Annual Survey of Hospitals, 535 acute care hospitals reported providing approximately $10.3 billion in charity care. Non-state owned hospitals provided $10.0 billion of the total charity care reported. Charity care refers to health services that are never expected to result in cash payments. State-owned hospitals reported providing $0.3 billion in charity care. A hospital's policy to provide healthcare services free of charge to individuals who meet certain financial criteria determines the extent of its charity care. Charity care charges are usually adjusted to reflect the difference between what hospitals commonly charge and what they receive in negotiated or discounted payments. When adjusted for the ratio of cost-to-charges, the amount of charity care reported by hospitals is reduced to approximately $3.1 billion (see **Figure 5**).

Out of the 535 reporting hospitals, 108 hospitals are owned by city, county, or hospital districts/authorities and five acute care hospitals are state-owned. The 108 local public hospitals reported $4.1 billion in charity care in fiscal year 2011, reduced to $1.5 billion when adjusted by the ratio of cost-to-charges. **Figure 6** shows that local public hospitals, which represent approximately 20 percent of the reporting hospitals, accounted for 48 percent of the total charity charges in fiscal year 2010.

A total of $1.4 billion in charity care (94 percent) reported by local public hospitals is attributed to six hospital districts—Bexar, Dallas, El Paso, Harris, Tarrant, and Travis (see **Figure 6**).

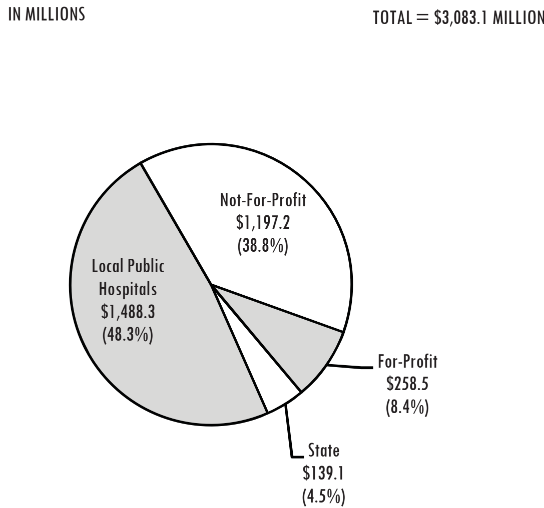
FIGURE 4
FEDERAL AND STATE SOURCES OF REIMBURSEMENT FOR UNCOMPENSATED CARE, FISCAL YEAR 2012

PROGRAM/AGENCY	DESCRIPTION	FISCAL YEAR 2012 DISTRIBUTION
Disproportionate Share Hospital Program (DSH) Health and Human Services Commission	Provides funding to hospitals that treat a disproportionate share of Medicaid and uninsured patients. The funding is intended to reimburse hospitals for the uncompensated care and additional costs from treating Medicaid patients. Texas uses funds from state-owned hospitals and intergovernmental transfers (IGTs) from large public hospitals to generate the funds needed to draw federal matching funds. Federal and state requirements define the hospitals eligible for payments. Hospitals receive payments based on federal limits and the state's methodology.	$314.4 million for state hospitals and $1.2 billion for non-state hospitals. DSH allocations included (in millions): • Chest Hospital: $27.4 • State Psychiatric Hospitals: $287.4 • Large Urban Public Hospitals: $616.1 ($116.5 after IGT) • Other Urban Hospitals: $488.1 • Children's: $51.5 • Rural hospitals: $45.8 These payments are based on IGTs of $499.6 million.
Section 1115 Waiver Transition/Uncompensated Care Payments (former Upper Payment Limit Program) Health and Human Services Commission	Provides hospitals with supplemental payments for uncompensated care costs for services provided to Medicaid eligible patients and uninsured patients. To receive Section 1115 Waiver Payments, the state uses matching intergovernmental transfer funds from hospitals that received UPL payments. Hospitals will receive transitional payments similar to prior year's UPL payments or based on the current maximum DSH limit to ensure financial stability for hospitals as the state transitions to the new waiver payment methodologies effective in the second year of the waiver.	$2.4 billion. Payment allocations included (in millions): • State teaching hospitals: $93.2 • Children's hospitals: $6.0 • Rural Hospitals: $86.7 • Private Hospitals: $1,157 • Urban hospitals: $1,007.4 These payments are based on IGTs of $977.5 million. Physician payments for practitioners - $75.8 million All Funds, $44.3 million Federal Funds, and $31.5 million IGT.
Tobacco Settlement Proceeds Department of State Health Services	Proceeds are distributed to cities, counties, and hospital districts based on their unreimbursed healthcare expenditures. Entities complete a county expenditure statement reflecting county indigent healthcare services, unreimbursed jail healthcare, additional unreimbursed personal healthcare services, and other expenditures.	Based on fiscal year 2011 expenditures of $2.5 billion, Department of State Health Services distributed a total of $6.0 million to counties, $43.9 million to hospital districts, and $61,435 to cities.
Trauma Funding Department of State Health Services	Uncompensated trauma care represents a source of uncompensated care for many of the state's 284 trauma-designated facilities. The Texas Legislature built a statewide emergency medical services and trauma care system in the Omnibus Rural Health Care Rescue Act in 1989. Trauma centers cannot refuse to accept a transfer patient based on insurance status, as required in the Texas Health and Safety Code and through federal law. For the purposes of state reimbursement, Texas hospitals reported fiscal year 2011 trauma charges of $773.5 million, reduced to $234.1 million when applying the cost-to-charge ratio.	The Designated Trauma Facility and Emergency Medical Services Account: Funded a portion of uncompensated trauma care to eligible state trauma facilities or a hospital meeting "in active pursuit" requirements. The program distributed $54.8 million in fiscal year 2012 based on uncompensated trauma charges from calendar year 2011. Emergency Medical Services and Trauma Care System Account and Emergency Medical Services, Trauma Facilities and Trauma Care Systems Fund: Provided $606,696 and $447,276, respectively, in additional uncompensated trauma care funds.

Source: Legislative Budget Board.

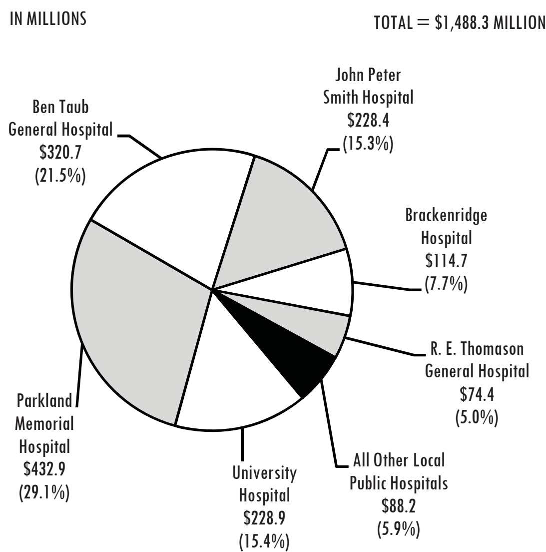
In addition to charity care, the 535 hospitals reported nearly $6.7 billion in bad debt. When this amount is adjusted for the ratio of cost-to-charges, the amount is approximately $1.8 billion (see **Figure 7**). Not-for-Profit and local public hospitals accounted for approximately 73 percent of the bad debt reported. Bad debt charges are uncollectible hospital charges that result from the extension of credit. Therefore, total uncompensated care, which combines charity care and bad debt, for these hospitals was reported to be approximately $4.9 billion when adjusted for the ratio of cost-to charges.

FIGURE 5
CHARITY CHARGES BY TYPE OF HOSPITAL
FISCAL YEAR 2011



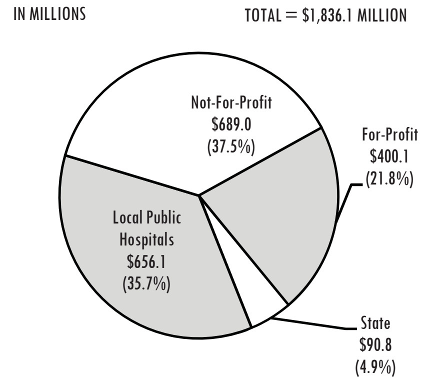
NOTE: Charity charges are adjusted by the ratio of cost-to-charges for each individual hospital. Local Public Hospitals include hospitals owned by cities, counties, hospital districts, hospital authorities and hospitals leased to not-for-profit organizations.
SOURCES: Legislative Budget Board; Texas Department of State Health Services.

FIGURE 6
CHARITY CARE REPORTED BY LOCAL PUBLIC HOSPITALS
FISCAL YEAR 2011



NOTE: Charity charges are adjusted by the ratio of cost-to-charges for each individual hospital.
SOURCES: Legislative Budget Board; Texas Department of State Health Services.

FIGURE 7
BAD DEBT CHARGES BY TYPE OF HOSPITALS
FISCAL YEAR 2011



NOTE: Bad debt charges are adjusted by the ratio of cost-to-charges for each individual hospital. Local Public Hospitals include hospitals owned by cities, counties, hospital districts, hospital authorities and hospitals leased to not-for-profit organizations.
SOURCES: Legislative Budget Board; Texas Department of State Health Services.

RECIPIENTS OF CHARITY CARE IN SIX LARGE TEXAS HOSPITAL DISTRICTS

To assess the population served and services delivered to charity care patients in 2011, data was collected from the six large hospital districts (Bexar, Dallas, El Paso, Harris, Tarrant, and Travis). Most charity programs provide healthcare services to indigent residents up to 250 percent level of the FPL at no cost, or require co-pays and/or premiums based on income levels (**Figure 8**). Information on the recipients of charity care is not readily available. DSHS' annual hospital survey does not request demographic information from hospitals on charity care patients.

Figures 9 and **10** show select characteristics for the number of charity patients in fiscal year 2011 at four hospitals surveyed by the Legislative Budget Board staff. From demographic data collected from four of the six public hospitals that account for a significant amount of local charity care spending, it was determined that 90.8 percent of the patients receiving some form of charity care were nonelderly adults (between the ages of 19 and 64).

The four hospitals also submitted demographic data based on encounters (i.e., inpatient, outpatient, and emergency visits). These four hospitals had a total of 1.7 million encounters in 2011.

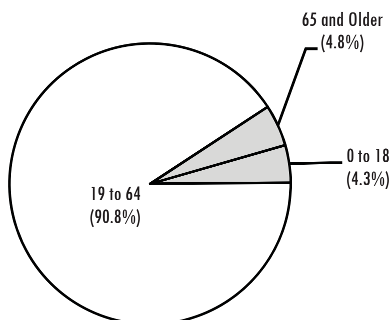
Despite the federal, state and local programs previously discussed, Texas continues to have a large uninsured

FIGURE 8
SELECT COUNTY CHARITY CARE PROGRAMS, FISCAL YEAR 2012

COUNTY/ PROGRAM NAME	PROGRAM DESCRIPTION	ELIGIBILITY
Bexar County Hospital District CareLink	University Health System (which includes University Hospital, the public hospital for Bexar County) serves a portion of its indigent residents through a membership program. Through CareLink, members have access to primary care and specialty care through a network of providers contracted with University Health System.	Patients with income up to 75 percent of the FPL receive free care and those with income above 75 percent of the FPL pay a sliding scale premium based on income and family size.
Dallas County Hospital District HEALTHplus	Parkland Health and Hospital System (Parkland) provides healthcare to indigent and/or medically needy residents of Dallas County. Parkland's healthcare services to indigent patients are provided in various settings such as hospitals, Community Oriented Primary Care clinics, specialty care clinics and emergency rooms.	Patients with family income up to 100 percent of the FPL and no third-party health insurance coverage have access to several levels of patient care with an increasing schedule of co-payments and monthly payment requirements.
El Paso County Hospital District HealthCARE Options	El Paso County Hospital District provides healthcare to indigent and uninsured county residents through its public hospital, R.E. Thomason Hospital, and primary care community care clinics (Thomason C.A.R.E.S.).	Patients with incomes below 50 percent of the FPL receive free care, and patients with income up to 200 percent of the FPL contribute to some portion of their healthcare costs.
Harris County Hospital District Financial Assistance Program	Indigent residents of Harris County may access healthcare services through Harris County Hospital Districts' (HCHD) three public hospitals, Ben Taub Hospital, LBJ Hospital, and Quentin Mease Community Hospital. In addition, indigent residents have access to primary care services through its Community Health Center Program.	Participants whose incomes fall below 200 percent of the FPL must make co-pays for healthcare services.
Tarrant County Hospital District JPS Connection	Tarrant County indigent residents participate and receive healthcare services throughout the JPS Health Network, which includes John Peter Smith Hospital and a network of community based health centers.	Indigent residents with income up to 200 percent of the FPL or medically indigent residents qualify for care at no charge or pay for co-pays based on household size and gross monthly income.
Travis County Hospital District Seton Care Plus	The Travis County Hospital District ensures access to healthcare services for indigent residents by contracting with Seton Healthcare Network, a non-profit health system. Seton Healthcare Network operates the only public hospital, Brackenridge Hospital, in Travis County.	Patients with income levels up to 250 percent of the FPL make minimal co-payments based on a sliding fee scale.

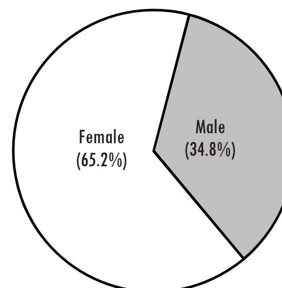
Source: Legislative Budget Board.

FIGURE 9
AGE DISTRIBUTION OF CHARITY CARE PATIENTS FISCAL YEAR 2011



Note: Figure reflects distribution at four hospitals.
Source: Legislative Budget Board.

FIGURE 10
GENDER DISTRIBUTION OF CHARITY CARE PATIENTS FISCAL YEAR 2011



Note: Figure reflects distribution at four hospitals.
Source: Legislative Budget Board.

population and high rates of uncompensated care. Some counties have greater uninsured populations to support than others. These counties are shown in **Figure 11**. A significant amount of Texas' uninsured population (62 percent) resides in 10 counties. Approximately half of Texas' uninsured population resides in six counties (Bexar, Dallas, El Paso, Harris, Tarrant, and Travis).

ACCESSING FEDERAL FUNDS FOR A MEDICAID EXPANSION

Hospitals that care for a disproportionate number of low-income and uninsured persons, known as "safety net" providers, must identify many sources of funding to continue to defray the cost of serving this population. A significant amount of unmatched local funds is spent on populations that could potentially be covered through a Medicaid match. With certain exceptions, federal law allows states to use intergovernmental transfers to obtain public funds for use as state match in the Medicaid program. According to a report by the National Association of Counties published in April 2010, 26 states use local revenue as the non-federal share to match federal funding for Medicaid programs and services. These states may require all or some counties to share in the cost of providing services for a variety of Medicaid services, from hospital inpatient services to case management services.

Most recently, some local governments in states where governors have rejected Medicaid expansion are exploring ways to expand Medicaid locally. Despite Arizona's long-standing objections to expanding its Medicaid program, Phoenix voters will consider a hospital tax that would generate state match to allow the expansion of Medicaid to childless adults. The City of New Orleans has a current Medicaid waiver that allows the city to provide preventative care at no charge and based on a sliding scale to uninsured low-income residents. The waiver expires in 2014, but city health officials hope to extend the waiver to expand Medicaid to adults.

In early October 2012, Centers for Medicare and Medicaid Services (CMS) approved a waiver that will allow Cook County, Illinois, to begin enrolling persons early in the expanded Medicaid program. The early implementation of the Medicaid expansion, including a two-year moratorium, was authorized by the Illinois General Assembly in May 2012. The local financed expansion is expected to add 100,000 to 250,000 adults to Medicaid coverage. The county explained that uninsured patients were already receiving medical care though emergency rooms and free clinics and that the waiver would save the county as much as $100 million.

Texas could amend the Medicaid State Plan to expand Medicaid coverage to certain low-income adults that are financed with local funds. As the single state agency designated to administer federal funds for Medicaid, HHSC must plan and direct the Texas Medicaid program in each agency that operates a portion of the program. In

FIGURE 11
TEXAS COUNTIES WITH THE 10 LARGEST UNINSURED POPULATIONS AND POTENTIALLY NEWLY MEDICAID ELIGIBLE UNINSURED POPULATION (18 TO 64 YEARS OF AGE WITH INCOMES BELOW 138 PERCENT OF THE FEDERAL POVERTY LEVEL)
FISCAL YEAR 2010

COUNTY	NUMBER OF UNINSURED	NUMBER OF UNINSURED POTENTIALLY MEDICAID ELIGIBLE	PERCENTAGE OF UNINSURED POTENTIALLY MEDICAID ELIGIBLE
Harris	1,117,424	383,843	34.4%
Dallas	663,878	231,537	34.9%
Tarrant	386,174	127,084	32.9%
Bexar	348,909	123,237	35.3%
Hidalgo	265,156	131,275	49.5%
El Paso	230,924	99,225	43.0%
Travis	212,259	79,899	37.6%
Cameron	134,358	64,592	48.1%
Collin	120,888	32,589	27.0%
Denton	109,698	30,444	27.8%
Total, 10 Counties	**3,589,668**	**1,303,725**	**36.5%**

NOTE: Fiscal year 2010 is the most recent year with available county-level data on the uninsured. Predetermined set of data includes persons age 18 that may already qualify for Medicaid.
SOURCES: Legislative Budget Board; Census Bureau's Small Area Health Insurance Estimates program.

administering this function, the agency is charged with administering the Medicaid State Plan. Recommendation 1 would amend the Texas Human Resources Code to authorize Medicaid expansion financed by local counties for the newly eligible population in select counties. The recommendation directs HHSC to amend the Medicaid State Plan and/or submit a Section 1115 Waiver.

Recommendation 2 would amend the Texas Human Resources Code to direct HHSC to amend the Medicaid State Plan or to submit a Section 1115 Waiver allowing Texas counties to expand Medicaid to 138 percent of the FPL. Recommendation 3 would amend statute to require HHSC to establish eligibility standards and requirements for counties choosing to expand Medicaid. It is unknown whether or the extent to which CMS would agree to these state plan amendments or waiver applications. HHSC would need to determine the detailed terms of such an expansion in an ongoing negotiation process with CMS.

The U.S. Supreme Court's ACA ruling rendering Medicaid expansion a state option resulted in ambiguity regarding the actual implementation details of the expansion. The ACA has not been amended to address the court's decision. Therefore, CMS will be responsible for issuing guidance and direction on state implementation of Medicaid expansion.

CMS has not yet issued formal guidance or rulemaking to guide states in this process. In response to an August 2012 U.S. Government Accountability Office report concluding that additional CMS guidance on expansion is needed, CMS stated that additional formal direction will be forthcoming. However, CMS officials have informally indicated a willingness to negotiate with states in the implementation of Medicaid expansion. At an August 2012 National Conference of State Legislatures summit, CMS Deputy Director Cindy Mann stated that CMS would allow states to participate in Medicaid expansion for a limited amount of time and then opt out of the expansion.

FISCAL IMPACT OF THE RECOMMENDATIONS

Legislative Budget Board staff estimates that expanding Medicaid statewide to the newly eligible adult population for the 2014–15 biennium would cost $50 million in General Revenue and draw $4.0 billion in Federal Funds. Assuming all ten counties shown in **Figure 11** would provide the non-federal share of $31.5 million, an estimated amount of $2.5 billion in Federal Funds would be available to provide Medicaid to newly eligible adults in those counties.

The provision of $31.5 million would potentially provide Medicaid coverage for 1.3 million adults for two fiscal years in the ten counties. This estimate is calculated by multiplying the ten counties' 62.9 percentage of potentially eligible adults statewide by the estimated statewide expanded Medicaid state cost for the upcoming biennium of $50 million. The aggregate estimate of Federal Funds received for these ten counties for fiscal years 2014 and 2015 is $2.5 billion. This amount is calculated by multiplying the ten counties' 62.9 percentage of potentially eligible adults statewide by the expanded statewide Medicaid estimated Federal Funds of $4.0 billion.

These local funds would not consist entirely of additional or new funds. It is anticipated that a substantial portion of these local funds would be used by counties for indigent care in the absence of the authority to expand Medicaid.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

MAXIMIZE FEDERAL FUNDING TO TEXAS HOSPITALS RECEIVING MEDICAID SUPPLEMENTAL PAYMENTS

Inpatient hospital payments made under the Texas Medicaid program totaled approximately $2.2 billion in state and federal funds in fiscal year 2011. Hospitals in Texas received Disproportionate Share Hospital and Upper Payment Limit payments that totaled about $4.3 billion in All Funds for fiscal year 2011. The amount of intergovernmental transfers from public hospitals increased from $1.2 billion in the 2002–03 biennium to an estimated $2.7 billion in the 2010–11 biennium. Select state-owned hospitals also provide intergovernmental transfers to draw down these supplemental payments.

The Health and Human Services Commission's Healthcare Transformation and Quality Improvement Program, or Medicaid Transformation Waiver, replaces Upper Payment Limit payments with a new Medicaid supplemental funding structure. Under the waiver, federal funds drawn down with intergovernmental transfers will now be pooled and distributed to hospitals (1) based on their uncompensated care and (2) to provide delivery system reform incentive payments for healthcare improvements. There is now an opportunity to generate new federal funds because the waiver authorizes the inclusion of clinical, physician, and pharmacy uncompensated care costs provided at hospitals in the calculation of total uncompensated care reimbursements. Before the waiver, only inpatient and outpatient services were included in Upper Payment Limit payments. However, the receipt of the new Federal Funds is contingent on the provision of additional non-federal match. The finite amount of available local funds has strained the existing Disproportionate Share Hospital funding structure as large public hospital districts explore using intergovernmental transfers to fund new waiver opportunities in lieu of Disproportionate Share Hospital payments. Although eight large public local hospitals put up the non-federal share, about 172 local hospitals receive a Disproportionate Share Hospital payment.

Expanding appropriation authority to select health-related institutions of higher education and establishing a hospital assessment fee for non-public hospitals would maximize federal funding to hospitals. Establishing a hospital assessment fee for non-public hospitals and accessing Disproportionate Share Hospital matching federal funds with the new revenue could provide relief to the local public hospitals that currently provide the non-federal share. The annual revenue from a 0.55 percent assessment on non-public hospital gross inpatient revenue would be approximately $510.7 million to be used as the non-federal match for the non state-owned Disproportionate Share Hospital program in fiscal year 2014.

CONCERNS

- Health-related institutions do not have the appropriation authority to provide intergovernmental transfers to draw down Federal Funds from the new Uncompensated Care and Delivery System Reform Incentive Payments pools.

- The state relies on intergovernmental transfers from state-owned hospitals to draw Disproportionate Share Hospital payments and the former Upper Payment Limit payments, which in turn "frees up" General Revenue Funds that the Comptroller of Public Accounts' Biennial Revenue Estimate counts as an increase. The University of Texas Medical Branch, The University of Texas MD Anderson Cancer Center, and The University of Texas Health Center at Tyler will not be able to maximize federal funding from the new Uncompensated Care and Delivery System Reform Incentive Payments pools during the 2014–15 biennium unless they are authorized to retain payments from the newly matched uncompensated care payments for clinical, pharmacy, and physician services.

- A group of eight large-volume Medicaid public hospitals that historically transferred local funds ($499 million in fiscal year 2012) to draw down Disproportionate Share Hospital Federal Funds for all qualifying non-state-owned hospitals may no longer be transferring these funds in fiscal year 2013. Instead, the hospitals may use these local funds to draw federal funds from the new Uncompensated Care and Delivery System Reform Incentive Payments pools.

RECOMMENDATIONS

- **Recommendation 1:** Include a rider in the introduced 2014–15 General Appropriations Bill authorizing health-related institutions of higher education to

make intergovernmental transfers of funds to the Health and Human Services Commission to draw down federal funds from the new Uncompensated Care and Delivery System Reform Incentive Payment pools.

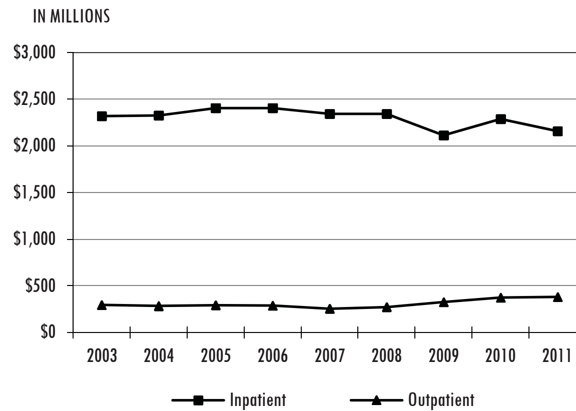
- ♦ **Recommendation 2:** Include a rider in the introduced 2014–15 General Appropriations Bill to ensure that state-owned teaching hospitals maximize federal funding by excluding uncompensated care payments for clinical, pharmacy, and physician services from amounts subject to deposit in un-appropriated General Revenue.
- ♦ **Recommendation 3:** Amend statute to require non-public hospitals pay an assessment fee, which will be used to generate the non-federal share of Disproportionate Share Hospital payments to local hospitals.

DISCUSSION

Medicaid is a joint federal-state partnership for providing medical care to cash assistance recipients (Temporary Assistance for Needy Families), children, pregnant women, and the elderly and disabled persons. Inpatient hospital services are mandated Medicaid benefits (i.e., must be provided to all Medicaid-eligible clients). There are 539 general, acute care and rehabilitation hospitals, 11 children's hospitals, 27 non state-owned psychiatric hospitals and 15 state-owned hospitals participating in the Texas Medicaid program. On average, there are about 643,000 admissions of Medicaid patients to these hospitals every year in Texas. Medicaid reimbursement for inpatient services is limited to $200,000 per client, per year (except for children).

Primary reimbursements for Medicaid providers are categorized as either fee-for-service or managed care. Fee-for-service payments reimburse providers for each billable service based on an established amount. **Figure 1** shows inpatient and outpatient services payments from federal fiscal years 2003 to 2011. In federal fiscal year 2011, inpatient and outpatient hospital expenditures were approximately $2.5 billion in All Funds.

FIGURE 1
TEXAS MEDICAID INPATIENT AND OUTPATIENT PAYMENTS, ALL FUNDS
FEDERAL FISCAL YEARS 2003 TO 2011



NOTE: Fiscal year 2011 is estimated for outpatient services.
SOURCES: Legislative Budget Board; Centers for Medicare and Medicaid Services.

CURRENT HOSPITAL REIMBURSEMENT POLICIES AND METHODOLOGIES

The federal government permits each state to develop its own hospital reimbursement methodology, subject to federal approval. Since 1987, Texas has reimbursed general acute care hospitals for inpatient hospital services provided to clients not served through managed care through a prospective payment system. Hospitals providing services to clients under managed care plans must negotiate with managed care organizations (MCO). The state Medicaid fee-for-service rates are used for negotiations between the hospitals and MCOs. Individuals remaining in fee-for-services include: children with Supplemental Security Income who opt out of managed care; children receiving adoption subsidies and children in foster care who are in transition, and those in Medicaid retroactive enrollment. A prospective payment system bases payments for inpatient services on a patient's diagnosis before the provision of services. Calculating a hospital payment involves three elements: (1) the Diagnosis Related Group (DRG), (2) the DRG relative weight, and (3) the statewide standard dollar amount (SDA). Effective September 1, 2011, general acute care hospitals receive a statewide SDA plus add-ons for geographical wage variances, teaching programs, and trauma designation. **Figure 2** shows how Medicaid payments are calculated for the different types of hospitals.

Outpatient hospital services covered for Medicaid recipients (approximately 1 million encounters per year at approximately 500 provider locations) consist of diagnostic, therapeutic, or rehabilitative services delivered in a licensed hospital setting. Rates for outpatient hospital reimbursement for providers operating outside of managed care are determined by using the federal Tax Equity and Fiscal Responsibility Act (TEFRA) reimbursement process. An interim payment rate is used

FIGURE 2
MEDICAID PAYMENT METHODOLOGY FOR HOSPITAL INPATIENT SERVICES, FISCAL YEAR 2012

HOSPITALS	REIMBURSEMENT SYSTEM	METHODOLOGY
General, Acute Care Hospitals	Prospective Payment System	The product of the DRG relative weight and the statewide SDA for the hospital is used to calculate the hospital's payment. Additional add-on payments are made for geographical wage variances, teaching programs, and trauma designation.
Children's Hospitals Small Hospitals Rural Hospitals	Retrospective Cost-based Reimbursement System (Tax Equity and Fiscal Responsibility Act)	An interim rate payment for Medicaid inpatient services is made to a hospital based on the historical relationship of costs compared to charges. At the end of a reporting cycle, an audit of costs is completed and it is determined if additional reimbursements or recoupments will occur.
Psychiatric Hospitals	Per Diem	Statewide per diem is calculated using cost data reports.

Sources: Legislative Budget Board; Health and Human Services Commission.

subject to cost settlement at year's-end. The final rate is 72.27 percent of allowable costs. Outpatient hospital rates for high-volume Medicaid hospitals are paid at 76.07 percent of cost.

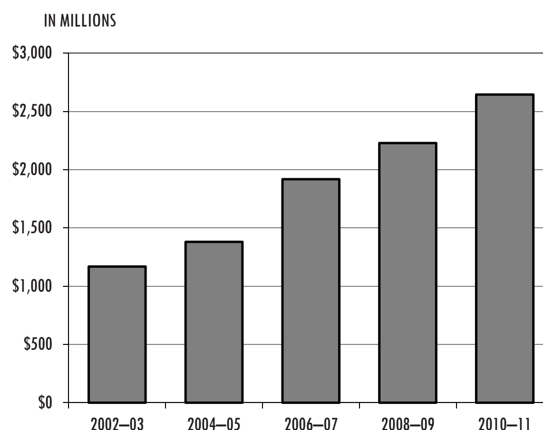
In addition to the two primary Medicaid reimbursements, Medicaid hospitals also receive supplemental payments. Medicaid supplemental payments consist of Upper Payment Limit (UPL) and Disproportionate Share Hospital (DSH) payments. The UPL program is premised on a fee-for-service Medicaid payment structure. UPL reimburses providers for the difference between the higher Medicare reimbursement level and Medicaid level for inpatient and outpatient services. The DSH program is intended to partially reimburse hospitals for the unreimbursed costs of providing services to Medicaid and indigent populations. Both supplemental payment streams are joint state-federal programs that are reimbursed by the federal government at a state's Federal Medical Assistance Percentage (FMAP).

Texas uses funds received by intergovernmental transfers (IGTs) from local governments, hospital districts, and state-owned hospitals as the state share of the supplemental payments. Participating hospital districts provide the state with local funds, which are then returned to hospital districts after receiving the federal match. Hospital eligibility for supplemental payments is based on meeting state and federal requirements. Payments are based on federal and state limits and methodologies. As shown in **Figure 3**, Texas' reliance on IGTs to provide the state share of funding supporting the UPL and DSH programs has increased substantially. Initially, only large urban hospitals participated in the UPL program but other hospitals (i.e., rural, private) were later included.

ACTIONS TAKEN BY THE EIGHTY-SECOND LEGISLATURE

In years leading up to the Eighty-second Legislature, Texas had increasingly moved away from Medicaid fee-for-service payments to a managed care model. However, because

FIGURE 3
INTERGOVERNMENTAL TRANSFERS BY TEXAS NON-STATE OWNED HOSPITALS
2002–03 TO 2010–11 BIENNIA



Sources: Legislative Budget Board; Health and Human Services Commission; Comptroller of Public Accounts.

Medicaid Upper Payment Limit supplemental payments are premised on a fee-for-service model, Texas could not implement statewide managed care without endangering the substantial UPL payment stream. The Eighty-second Legislature, Regular Session, 2011, charged the Health and Human Services Commission (HHSC) with implementing the statewide-managed care of Medicaid, but only if HHSC was able to simultaneously protect the UPL funding stream.

Health and human services agencies were also directed to identify and implement Medicaid cost containment measures in the 2012–13 biennium. Rider 61 in HHSC's bill pattern of the 2012–13 General Appropriations Act reduced the agency's appropriations by $450 million in General Revenue Funds; however, initiatives specifically identified in the rider are only estimated to save $355 million in General Revenue

Funds. Section 16 of Special Provisions Relating to All Health and Human Services Agencies also included cost containment measures that directed HHSC to reduce provider rates. Hospital inpatient and outpatient services were reduced by 8 percent. **Figure 4** shows hospital-related cost containment measures.

FIGURE 4
HOSPITAL-RELATED COST CONTAINMENT INITIATIVES
FISCAL YEARS 2012 TO 2013

EFFECTIVE DATE	INITIATIVE
September 1, 2011	• Rate reduction of 8 percent. • Cost and day outlier payments reduced by 10 percent. • Statewide standard dollar amount with add-ons to recognize high-cost circumstances (wage index, trauma, teaching hospitals). • Reduction in payments for non-emergency services provided in hospital emergency departments. • Fee schedule for outpatient (imaging services) Medicaid payments. • Improving birth outcomes by reducing birth trauma and elective inductions.
September 1, 2013	• Hospital adjustments for potentially preventable readmissions.

Sources: Legislative Budget Board; Health and Human Services Commission.

In 2003, legislation was enacted that established the Designated Trauma Facility and Emergency Medical Services (DTF/EMS) Account. General Revenue–Dedicated Funds collected under this account support a portion of the uncompensated trauma care provided by eligible trauma facilities. As a result of Senate Bill 7 passed by the Eighty-second Legislature, First Called Session, 2011, the Department of State Health Services (DSHS) is authorized to use General Revenue–Dedicated (Trauma Funds Account) as match for Medicaid. For fiscal year 2012, DSHS transferred $26 million in General Revenue–Dedicated Funds (Trauma Funds Account) to HHSC to establish a trauma add on reimbursement for designated trauma facilities that qualify for SDA payments.

TEXAS HEALTHCARE TRANSFORMATION AND QUALITY IMPROVEMENT PROGRAM

In 2011, HHSC worked with the Centers for Medicare and Medicaid Services (CMS) to amend the Texas Medicaid plan to incorporate statewide managed care implementation while preserving the UPL federal funding to implement a new supplemental payment stream. CMS authorized the Texas Medicaid plan pursuant to the U.S. Health and Human Services Secretary's legal authority provided in the federal Social Security Act, Section 1115, to waive certain provisions of federal law relating to Medicaid state plans under specified conditions. HHSC refers to the new payment structure as the Texas Healthcare Transformation and Quality Improvement Program, or the Medicaid Transformation Waiver.

The Medicaid Transformation Waiver is a five-year project that began September 1, 2011. The first year provides a transition period in which payments are based on prior year payments. In the second through fourth years, the new financing structure will be implemented.

Because it no longer uses a fee-for-service reimbursement for services to most Medicaid clients, the Texas Medicaid plan cannot use the UPL program. However, the Medicaid Transformation Waiver secured federal funding to make hospital payments from two new funding pools: the Uncompensated Care (UC) pool and the Delivery System Reform Incentive Payment (DSRIP) pool. The UC pool is intended to partially reimburse providers for costs associated with uncompensated or indigent care, while the Delivery System Reform Incentive Payment pool is designed to spur infrastructure or systemic improvements. **Figure 5** shows the distribution of $29 billion in All Funds available to Texas across the two pools over the five-year waiver period.

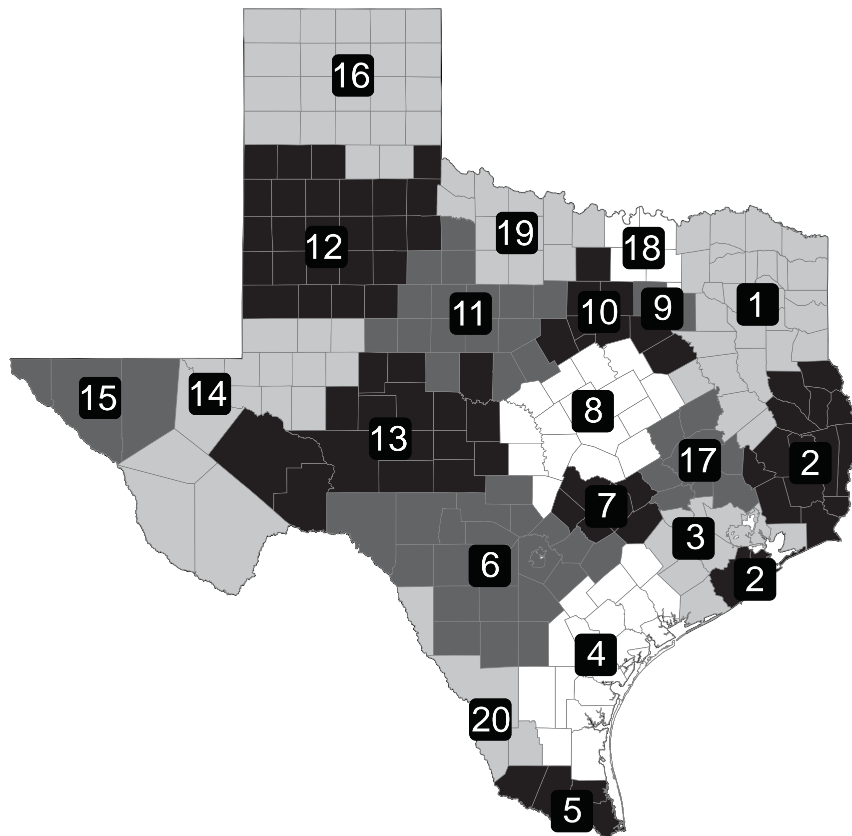
To receive a payment from either pool, providers and hospitals must participate in a Regional Healthcare Partnership (RHP). In 2012, HHSC established 20 geographically designated RHPs throughout the state, with each anchored by a public hospital or another public entity. **Figure 6** shows the final map of RHP regions. Anchoring entities are responsible for coordinating regional activities and submission of RHP plans to HHSC. RHP plans must specify regional IGT entities and describe DSRIP plans and be approved by both HHSC and CMS. HHSC has established four RHP tiers. RHP tiers are based on an RHP's percentage of state residents earning under 200 percent of the federal poverty level (FPL) and the number of public hospitals and the amount of uncompensated care they provide. For example, an RHP with more than 15 percent of the state's total population under 200 percent of the FPL is a Tier 1 RHP. An RHP with less than 3 percent of the state's total population under 200 percent of the FPL, lacking a public hospital, or with a public hospital providing less than 1 percent of the region's uncompensated care is a Tier 4 RHP.

FIGURE 5
MEDICAID TRANSFORMATION WAIVER ALL FUNDS DISTRIBUTION, DEMONSTRATION YEARS 2011 TO 2016

POOL	2011–12	2012–13	2013–14	2014–15	2015–16	TOTALS
Uncompensated Care	88%	63%	57%	54%	50%	60%
Delivery System Reform Incentive Payment	12%	37%	43%	46%	50%	40%
Total (In billions)	**$4.2**	**$6.2**	**$6.2**	**$6.2**	**$6.2**	**$29.0**

Note: Fiscal year 2011 hospital UPL payments totaled $2.8 billion.
Source: Health and Human Services Commission.

FIGURE 6
REGIONAL HEALTHCARE PARTNERSHIP REGIONS
FISCAL YEAR 2012



Note: Numbers correspond to each Regional Healthcare Partnership Region.
Source: Health and Human Services Commission.

UNCOMPENSATED CARE POOL PAYMENTS

Payments from the UC pool are intended to simplify the reimbursement of uncompensated and indigent care costs. Unlike the UPL reimbursement methodology, which was based on charges for procedures, UC payments are based on actual incurred costs. Costs are calculated from information submitted to HHSC on the hospital or physician UC reporting tools. Also unlike the UPL reimbursement method, hospital UC costs may include physician and mid-level professional costs related to direct patient care services and pharmacy costs attributable to the Texas Vendor Drug Program. Allowable physician costs include those related to direct patient care services, non-capital equipment and supply costs, and provider-specific indirect costs. UC payments for the first year of the waiver are scheduled for January 2013. However to avoid potential financial hardship for providers due to the timing of UC payments, HHSC will provide advance UC payments for certain eligible hospitals and physician group practices. Eligible providers include:

(1) hospitals that participated in the DSH program in federal fiscal year 2012; and/or (2) providers that received a Transition Waiver (formerly UPL) payment in federal fiscal year 2012.

DELIVERY SYSTEM REFORM INCENTIVE PAYMENTS

The DSRIP pool is intended to spur long-term improvements in the delivery of healthcare. HHSC has established four DSRIP categories: (1) infrastructure development; (2) program innovation and design; (3) quality improvements; and (4) population focused improvements. Each RHP tier has a minimum number of required DSRIP projects. The minimum required projects must be selected from Categories 1 or 2, with at least half from Category 2. Minimum total required project numbers are 20 for Tier 1, 12 for Tier 2, 8 for Tier 3, and 4 for Tier 4. DSRIP projects provide an opportunity for the improvement of regional and local healthcare systems with partial federal funding.

An example of a potential category 1 project is the expansion of a Graduate Medical Education (GME) program. The Texas GME program provides General Revenue Funds for residency programs for health-related institutions (HRIs) of higher learning. Opportunities may exist for RHP-participating HRIs to use GME General Revenue Funds to leverage additional federal funds through the DSRIP pool. Health-related institutions do not have the appropriation authority to provide intergovernmental transfers to draw down funds from the new Uncompensated Care and Delivery System Reform Incentive Payments pools. Recommendation 1 would include a rider to Special Provisions Relating Only to State Agencies of Higher Education in the introduced 2014–15 General Appropriations Bill to authorize health-related institutions to make an intergovernmental transfer of funds to HHSC to draw down federal funds from the new Uncompensated Care and Delivery System Reform Incentive Payments pools.

Although the waiver allows for a substantial increase in the amount of federal funding under the two pools, Texas still must provide the non-federal portion. To receive more federal funds, Texas must provide more non-federal funds. Therefore, hospital districts and local governments must provide increased IGT amounts to the state. Throughout fiscal years 2011 and 2012 legislative interim hearings, local hospital districts and county governments have expressed concern that they do not have sufficient IGT funds available to draw down the maximum amount of federal funds available under the waiver. The large counties, which have the potential to transfer large IGT amounts under the waiver, have also traditionally provided the non-federal share of the Disproportionate Share Hospital Funds not appropriated by the state.

DISPROPORTIONATE SHARE HOSPITAL PROGRAM

Due to the expectation of significant reductions in the number of uninsured individuals resulting from the expansion of overall health insurance coverage, the federal Affordable Care Act (ACA) includes a provision to scale back DSH funding for uninsured patients. The U.S. Department of Health and Human Services (DHHS) is charged with developing a methodology that imposes the largest percentage of reductions on states that have fewer uninsured people, and hospitals with low levels of uncompensated care and low volumes of Medicaid patients. Nationwide, DSH payments will be reduced by $500 million in fiscal year 2014, $600 million in fiscal years 2015–16, $1.8 billion in fiscal year 2017, $5 billion in fiscal year 2018, $5.6 billion in fiscal year 2019, and $4 billion in fiscal year 2020. The reduction to Texas' allocation is unknown at this time. Texas' preliminary federal DSH allotment in federal fiscal year 2012 is $979.3 million for state and non-state hospitals. The Middle Class Tax Relief and Job Creation Act of 2012 extends the fiscal year 2020 DSH reductions to fiscal year 2021.

DSH payments are funded using the same matching rate as medical services (58.22 percent Federal Funds, 41.78 percent state funds in federal fiscal year 2012). Both the state-owned and non-state DSH hospitals use intergovernmental transfers (IGTs) to supply the non-federal share of Medicaid funding.

STATE-OWNED DISPROPORTIONATE SHARE HOSPITAL PROGRAM

Appropriations made to state-owned hospitals are counted as match for the DSH Program. These include The University of Texas Health Science Center at Tyler (UTHSC-Tyler), Texas Center for Infectious Disease and nine state-owned or state-funded mental health facilities. The University of Texas Medical Branch at Galveston (UTMB) and The University of Texas M.D. Anderson Cancer Center (MD Anderson) no longer receive DSH payments due to their increase in UPL payments. DSH payment methodology requires any supplemental Medicaid payments be considered in a hospital's specific limit (Medicaid shortfall plus Uncompensated Care costs). DSH federal rules do not allow hospitals to receive DSH payments higher than their hospital specific limit.

The state-owned hospitals participating in the DSH and UPL program transfer non-federal appropriated funds to HHSC in the amount of their DSH and UPL allocation. HHSC returns to the state-owned hospitals the same amount of funds in state and federal dollars. Rider language in the introduced 2014–15 General Appropriation Bill directs HHSC to transfer the remaining balance of transferred funds, which is equal to the amount of matching federal funds obtained, to the State Treasury as unappropriated General Revenue Funds. The Comptroller of Public Accounts' Biennial Revenue Estimate counts this amount as a net increase. **Figure 7** shows deposits of General Revenue Funds generated by DSH and UPL transfers from the state-owned hospitals from fiscal years 2001 to 2011.

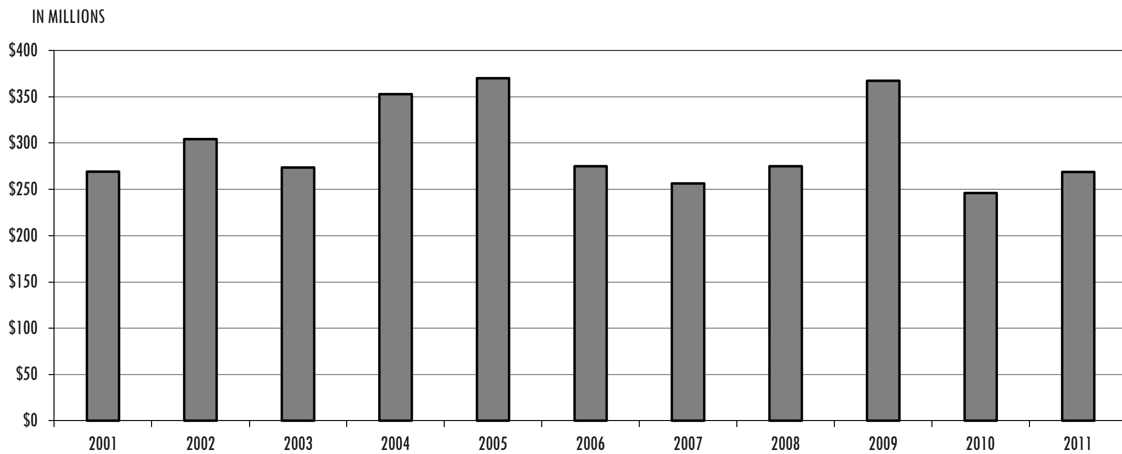
Recommendation 2 would add a rider in the introduced 2014–15 General Appropriations Bill to ensure that transferred funds in excess of those necessary to make DSH and Uncompensated Care Payments (inpatient and outpatient services) will continue to be transferred to unappropriated General Revenue. The rider language of Recommendation 2 would exclude payments for clinical, pharmacy, and physician services from being subject to deposit as unappropriated General Revenue. This exclusion allows UTMB, UTHSC-Tyler and MD Anderson to maximize federal funding from the new Uncompensated Care and Delivery System Reform Incentive Payments pools.

NON-STATE OWNED DISPROPORTIONATE SHARE HOSPITAL PROGRAM

A second group of nine large-volume Medicaid public hospitals transfers local funds to draw down the remaining DSH Federal Funds. The Texas Coalition of Transferring Hospitals (TCTH), consisting of nine hospital districts, includes Bexar, Dallas, Ector, El Paso, Harris, Lubbock, Nueces, Tarrant, and Travis. Nueces County Hospital District no longer participates in DSH program but remains a member of the TCTH. This is a voluntary arrangement, which HHSC negotiates with these hospitals. Although eight of these large public hospitals put up the matching funds, about 172 local hospitals receive a DSH payment through this program. However, because of the availability of increased federal funds under the Medicaid Transformation Waiver, these hospitals were faced with the decision of using their local funds for statewide DSH payments or for community investment with DSRIP initiatives.

In February 2012, HHSC received a proposal from TCTH that proposed a change to the DSH funding methodology. HHSC published the proposal for public review and comment. Following the comment period, an agreement was reached for fiscal year 2012 in which transferring hospitals will increase their amount of IGTs from the previous year and HHSC would establish pre-determined funding pools for the different groups of hospitals. Two factors have led the transferring hospitals to request a change to the distribution of DSH payments. According to HHSC, the proportion of the matching federal funds generated by the transferring hospitals' IGTs that are returned to them through DSH

FIGURE 7
STATE-OWNED HOSPITALS' DISPROPORTIONATE SHARE HOSPITAL PROGRAM AND UPPER PAYMENT LIMIT TRANSFERS TO GENERAL REVENUE FUNDS, FISCAL YEARS 2001 TO 2011



Sources: Legislative Budget Board; Comptroller of Public Accounts.

payments has decreased from approximately 50 percent in federal fiscal year 1996 to an estimated 14 percent for federal fiscal year 2012. Transferring hospitals will receive a higher return on their investment of IGT funds through funding the non-federal share of their uncompensated physician, clinic, and pharmacy costs under the 1115 Waiver than they would receive through funding DSH under its current distribution methods.

The Texas Association of Voluntary Hospitals (TAVH) developed another proposal to modify the DSH program. TAVH is comprised of a group of Texas non-profit hospitals. This alternative proposal would remove state-owned hospitals from the DSH program, which would allow the DSH program to distribute more funds to non-state facilities. The proposal would still require IGTs from TCTH, but the DSH payment methodology would be modified to increase the transferring hospitals' share of DSH funding.

In August 2012, HHSC proposed rules making the receipt of waiver payments conditional upon the mandatory transfer of the non-federal share of DSH hospital payments "in an amount prescribed by HHSC." Implementation of a rule authorizing HHSC to prescribe mandatory DSH transfers would give HHSC increased control over the ratio between and amounts and percentages of local funds supporting the waiver pools and DSH funding. However, providing additional sources of non-federal revenue will increase the likelihood of fully maximizing federal funds available under both the waiver and the DSH program.

HEALTH PROVIDER ASSESSMENTS AND TAXES

Under federal law, a state may impose an assessment, tax, or fee on certain classes of healthcare providers. However, the Social Security Act Section 1903(w) specifies that unless they are "broad based," healthcare-related taxes collected by a state are subtracted from federal Medicaid funding amounts due. Broad based taxes must be imposed uniformly on, at a minimum, all non-federal and non-public providers of a class of health-care items or services. Qualifying uniformly applied taxes may not allow credits, exclusions, or deductions resulting in a return of tax funds to the provider, or create a similar "hold harmless" scenario. These prohibitions are not violated unless the amount of taxes returned to a provider exceeds six percent of the provider's net patient revenues. However, federal law provides the U.S. DHHS Secretary authority to waive these requirements for certain providers, or upon a state showing that the tax and associated expenditures are generally redistributive and are not positively correlated to Medicaid payments.

Because broad based taxes are excepted from the statutory prohibition, states may use revenues from such assessments under limited circumstances to pay up to 25 percent of the state share of Medicaid spending. Doing so allows the state to leverage the revenue generated by an assessment to draw down additional matching federal funds.

Forty-seven states, including Texas, use provider taxes in connection with their Medicaid program. More than three-quarters of states impose provider taxes on nursing facilities. Approximately two-thirds of states subject hospitals or intermediate care facilities for developmentally disabled people. Managed care organizations are subject to a provider tax in 11 states. Several states, including, Maine, Massachusetts, and Vermont have used provider taxes to finance large-scale comprehensive statewide healthcare reform programs or coverage expansion initiatives.

The Texas Health and Safety Code, Chapter 252, Subchapter H, establishes a quality assurance fee (QAF) for certain community and state mental health and mental retardation facilities. Section 252.202 specifies that HHSC shall set the QAF based on patient days and facility gross receipts over a period of at least six months, but that the fee may not exceed 6 percent of the facility's total annual Texas gross receipts. The statute specifies that the QAF is an allowable Medicaid reimbursable cost.

The Texas life, health, and accident insurance premium tax is levied at 1.75 percent of the taxable gross premiums of any insurer, health maintenance organization (HMO), or managed care organization (MCO). Although this tax predates Medicaid, the portion of this tax collected from HMOs and MCOs is considered a provider assessment under the applicable federal definitions.

While federal regulations provide for the enactment of provider taxes, the federal government scrutinizes provider tax structures for adherence to requirements in state plan amendments and waiver applications. Several states in the past have encountered difficulty in seeking federal approval of provider tax structures, typically relating to efforts to exempt certain providers. However, in recent years several states have submitted request for waivers of provider tax requirements. **Figure 8** shows select states and the type of facility that are exempt from the state's hospital assessment fee.

FIGURE 8
STATES WITH HOSPITAL ASSESSMENTS THAT EXEMPT SELECT FACILITIES
FISCAL YEAR 2012

STATE	EXEMPT FACILITIES
California	Public Hospitals
Colorado	Institutions of Mental Disease Rehabilitation Hospitals Long-term Care Hospitals
Oklahoma	Specialty hospitals State-owned hospitals.
Oregon	Institutions of Mental Disease

Source: Legislative Budget Board.

TEXAS HEALTH OPPORTUNITY POOL TRUST FUND

The Texas Government Code, Chapter 531, Subchapter N, establishes the Texas Health Opportunity Pool Trust Fund (HOP Trust Fund). Established in 2007, the statute directs HHSC to seek a federal waiver to more efficiently use federal and local funds transferred by IGT relating to Medicaid supplemental payment programs. The Comptroller of Public Accounts is required to deposit in the HOP Trust Fund all federal monies provided to the state under the terms of the HOP Waiver, and state monies appropriated to the fund. The statute establishes the HOP Trust Fund as an account outside the State Treasury to be administered by HHSC. The purpose of the fund is to reimburse provider uncompensated care costs, to reduce the number of Texans without health benefit coverage, to reduce the need for uncompensated healthcare, and any other specified purpose. The waiver was submitted in April 2008 for approval but negotiations were not continued.

IMPLEMENTATION OF A NEW PROVIDER ASSESSMENT FEE FOR HOSPITALS

Amending the HOP Trust Fund (Recommendation 3) to require a provider assessment on non-public hospitals would establish a new source of non-federal funds eligible to be matched with federal funds. Generation of an additional revenue source increases the likelihood that Texas can maximize available federal funds under the current 1115 waiver and the DSH program. The Health Opportunity Pool statute would need to be updated to reflect the structure of HHSC's new 1115 waiver.

An assessment fee on hospitals could be applied in several forms and could therefore generate a range of revenue and have a range of impact on these providers. The design of an assessment fee and how funds are used will likely affect the estimates of impact on providers. **Figure 9** shows five populous states' use of hospital assessments/taxes. The profiles include: rate of assessment; amount of revenue generated from assessment; and general disposition of that revenue.

The finite amount of available local funds has strained the existing Disproportionate Share Hospital funding structure as large public hospital districts explore using intergovernmental transfers to fund new waiver opportunities in lieu of DSH payments. Non-public hospitals have an opportunity to provide the non-federal share to draw DSH payments through a QAF. Implementing a QAF provides policymakers a clear step towards maximizing Federal Funds. Additionally, the increasing number of hospital provider taxes enacted and the federal approval of provider tax waivers

FIGURE 9
PROFILES OF STATE HOSPITAL ASSESSMENTS, FISCAL YEAR 2012

STATE	HOSPITAL ASSESSMENT USE
California	• The current assessment methodology varies fee amounts based on payor source and type of payment. • An estimated $1.6 billion in fiscal year 2012 is generated from current assessments to support the state's Medicaid supplemental payments to private hospitals.
Florida	• The current rate of assessment is 1.5 percent of net operating revenues on inpatient hospital services. • An estimated $733.9 million in fiscal year 2012 (based on fiscal year 2010 inpatient revenue) is generated from current assessments to support the state's Medicaid program.
Illinois	• The current rate of assessment is set for each hospital ($218.38 multiplied by the difference of the hospital's occupied bed days less the hospital's Medicare bed days). • An estimated $900 million in fiscal year 2012 is generated from current assessments to provide additional Medicaid funding to hospitals.
New York	• The current rate of assessment on hospitals is 0.35 percent of cash operating receipts. • An estimated $271.2 million in fiscal year 2011 is generated to support the state's Medicaid program.
Pennsylvania	• The current rate of the assessment for each covered hospital is up to 3.22% of net inpatient revenue. • An estimated $500 million in fiscal year 2012 is generated to support the state's Medicaid program.

Source: Legislative Budget Board.

in several states illustrate the viable opportunity for states to generate additional revenue to assist in accessing additional federal funding. For these reasons, expansion of Texas' QAF to non-public hospital merits consideration. An assessment on non-public hospital's gross inpatient revenue would generate the following approximate amounts to provide the non-federal match for DSH payments for a full fiscal year:

- $325.0 million from an assessment of 0.35 percent on gross inpatient revenue;
- $417.8 million from an assessment of 0.45 percent on gross inpatient revenue; and
- $510.7 million from an assessment of 0.55 percent on gross inpatient revenue.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendations 1 and 2 would result in a net gain in Federal Funds in the 2014–15 biennium for HRIs. The amount of Federal Funds cannot be determined due to the variety of eligible DSRIP projects, RHP selection and state and federal approval process. Recommendation 1 and 2 would allow HRIs to maximize federal funds from the UC and DSRIP pools. Recommendation 3 would be a net gain to the Texas Health Opportunity Pool held outside the State Treasury. The net gain from a hospital assessment on non-public hospitals would fall in a range of $325.0 million to $510.7 million per fiscal year. Texas hospitals would use this net gain to continue to match federal DSH funds and the large public hospitals would be able to maximize Federal Funds under the Medicaid Transformation Waiver.

The introduced 2014–15 General Appropriations Bill includes riders to implement Recommendations 1 and 2.

OVERVIEW OF STATE-FUNDED SERVICES FOR PERSONS WITH INTELLECTUAL AND DEVELOPMENTAL DISABILITIES IN TEXAS

Local authorities are the single-point of access to publicly-funded services and supports for persons with intellectual and developmental disabilities in their service area. A "local authority" is a local government entity formed through an inter-local agreement, typically between one or more counties, cities, hospital districts, and school districts. Typically, a local authority and a local mental health authority co-operate as one community center, providing a variety of services. The Department of Aging and Disability Services contracts with 39 local authorities to perform certain delegated tasks and to oversee provision of state-funded services, sometimes referred to as safety net services. These entities served a monthly average of 12,741 and 12,422 Texans in fiscal years 2010 and 2011, respectively, while receiving approximately $218.7 million in state funding for both years.

There are several major budget and policy issues affecting the local authority system. Changes in the Department of Aging and Disability Services' budget structure and performance measures have been implemented in the fiscal years 2014–15 General Appropriations Bill to increase clarity and transparency about the amount of funding provided to local authorities and the purposes for which the funds are spent. Challenges confronting the local authority system include providing service coordination for certain Medicaid clients, refinancing of state-funded clients, adjusting service provision based on budget reductions that occurred during the Eighty-second Legislature, 2011, and building capacity to respond to crisis situations.

FACTS AND FINDINGS

- ♦ Local authorities used state funds to serve 22,181 individuals in fiscal year 2010 and 20,993 individuals (unduplicated) in fiscal year 2011. The level of services received varies by local authority based on the person's needs and available resources.
- ♦ Approximately one-third of the total funding for intellectual and developmental disability services that local authorities receive is in General Revenue Funds from the Department of Aging and Disability Services. Local authorities reported receiving $110.0 million and $108.7 million in fiscal years 2010 and 2011, respectively, in General Revenue Funds. The allocations in fiscal years 2012 and 2013 were $77.3 million and $72.2 million in General Revenue Funds.
- ♦ The Texas Legislature has expanded the responsibilities of local authorities in recent years. New functions include discussion of community living options with residents of state supported living centers and service coordination for certain consumers with intellectual and developmental disabilities. Service coordination assists clients in gaining access to necessary medical, social, educational, and other services to improve their quality of life and increase community participation.
- ♦ The Eighty-second Legislature directed the Department of Aging and Disability Services to refinance up to 5,000 consumers from services funded with General Revenue Funds to the Texas Home Living 1915(c) Medicaid waiver to enable Texas to draw federal funds for services which were previously funded using only state funds.
- ♦ Having the capacity to respond to crisis situations is becoming a significant issue for the local authority system. Local authorities anticipate spending an average of $295,243 on crisis services in fiscal year 2013, an amount that represents 17.0 percent of the average local authority's state funding in fiscal year 2012.

DISCUSSION

Local authorities are the single-point of access to publicly funded services and supports for persons with intellectual and developmental disabilities (IDD) in their service area. Local authorities were previously known as Mental Retardation Authorities until the Department of Aging and Disability Services (DADS) renamed them to comply with House Bill 1481, Eighty-second Legislature, 2011, a bill that requires use of Person-First Respectful Language. Some legacy references remain in statute, administrative rules, and program terminology.

A local authority is a local government entity formed through an inter-local agreement, typically between one or more counties, cities, hospital districts, and school districts. Each local authority is governed by a board of trustees. Typically, a local authority and a local mental health authority co-operate

as one community center, providing a variety of services including behavioral health and services for persons with IDD.

HISTORY OF LOCAL AUTHORITIES IN TEXAS

The U.S. Congress passed legislation in 1963 and 1965 authorizing the creation of community-based centers to serve persons with IDD and mental health conditions and providing federal funding. In 1965, the Texas Legislature passed the Texas Mental Health and Mental Retardation Act, which authorized creation of community centers, which now include both local authorities and local mental health authorities to administer mental health, IDD, and substance abuse programs. The legislation also established the Texas Department of Mental Health and Mental Retardation (TDMHMR), codifying the state's role in the federal, state, and local partnership in the provision of IDD and mental health services.

The system of local authorities that emerged in Texas was driven by local forces. Since 1965, local government entities voluntarily formed community centers across the state. In areas not served by a center, the state provided services through State-operated Community Services (SOCS), which were based out of state supported living centers (SSLCs) (then called state schools). By 2000, it was no longer necessary for the state to provide services through SOCS because all counties were served by a local authority. Since fiscal year 2000, there have been some additional closures and consolidations of local authorities, mostly driven by local preferences. Today, there are 39 local authorities; 38 of these are operated by community centers and 1 is operated by the Alamo Area Council of Governments (Bexar County Local Authority). **Figure 1** shows the local authority service areas.

FIGURE 1
LOCAL AUTHORITY SERVICE AREAS, 2012

NAME OF COMMUNITY CENTER	COUNTIES
ACCESS	Anderson, Cherokee
Andrews Center Behavioral Healthcare System	Henderson, Rains, Smith, Van Zandt, Wood
Austin Travis County Integral Care	Travis
Betty Hardwick Center	Callahan, Jones, Shackelford, Stephens, Taylor
Bexar MRA	Bexar
Bluebonnet Trails Community Services	Bastrop, Burnet, Caldwell, Fayette, Gonzales, Guadalupe, Lee, Williamson
Border Region Behavioral Health Center	Jim Hogg, Starr, Webb, Zapata
MHMR Authority of Brazos Valley	Brazos, Burleson, Grimes, Leon, Madison, Robertson, Washington
Burke Center	Angelina, Houston, Jasper, Nacogdoches, Newton, Polk, Sabine, San Augustine, San Jacinto, Shelby, Trinity, Tyler
Camino Real Community Services	Atascosa, Dimmit, Frio, Karnes, La Salle, Maverick, McMullen, Wilson, Zavala
Center for Life Resources	Brown, Coleman, Comanche, Eastland, McCulloch, Mills, San Saba
Central Counties Services	Bell, Coryell, Hamilton, Lampasas, Milam
Central Plains Center	Bailey, Briscoe, Castro, Floyd, Hale, Lamb, Motley, Parmer, Swisher
Coastal Plains Community Center	Aransas, Bee, Brooks, Duval, Jim Wells, Kenedy, Kleberg, Live Oak, San Patricio
Community Healthcore	Bowie, Cass, Gregg, Harrison, Marion, Panola, Red River, Rusk, Upshur
MHMR Services for the Concho Valley	Coke, Concho, Crockett, Irion, Reagan, Sterling, Tom Green
Metrocare Services	Dallas
Denton County MHMR Center	Denton
El Paso Center (Now known as Emergence Health Network)	El Paso
Gulf Bend Center	Calhoun, DeWitt, Goliad, Jackson, Lavaca, Refugio, Victoria
Gulf Coast Center	Brazoria, Galveston
MHMR Authority of Harris County	Harris

FIGURE 1 (CONTINUED)
LOCAL AUTHORITY SERVICE AREAS, 2012

NAME OF COMMUNITY CENTER	COUNTIES
Heart of Texas Region MHMR Center	Bosque, Falls, Freestone, Hill, Limestone, McLennan
Helen Farabee Centers	Archer, Baylor, Childress, Clay, Cottle, Dickens, Foard, Hardeman, Haskell, Jack, King, Knox, Montague, Stonewall, Throckmorton, Wichita, Wilbarger, Wise, Young
Hill Country Mental Health & Developmental Disabilities Centers	Bandera, Blanco, Comal, Edwards, Gillespie, Hays, Kendall, Kerr, Kimble, Linney, Llano, Mason, Medina, Menard, Real, Schleicher, Sutton, Uvalde, Val Verde
Lakes Regional MHMR Center	Camp, Delta, Ellis, Franklin, Hopkins, Hunt, Kaufman, Lamar, Morris, Navarro, Rockwall, Titus
LifePath Systems	Collin
Lubbock MHMR (Now known as StarCare Specialty Health System)	Cochran, Crosby, Hockley, Lubbock, Lynn
MHMR of Nueces County	Nueces
Pecan Valley Centers for Behavioral & Developmental HealthCare	Erath, Hood, Johnson, Palo Pinto, Parker, Somervell
Permian Basin Community Centers for MHMR	Brewster, Culberson, Ector, Hudspeth, Jeff Davis, Midland, Pecos, Presidio
Spindletop Center	Chambers, Hardin, Jefferson, Orange
MHMR of Tarrant County	Tarrant
Texana Center	Austin, Colorado, Fort Bend, Matagorda, Waller, Wharton
Texas Panhandle Centers	Armstrong, Carson, Collingsworth, Dallam, Deaf Smith, Donley, Gray, Hall, Hansford, Hartley, Hemphill, Hutchinson, Lipscomb, Moore, Ochiltree, Oldham, Potter, Randall, Sherman, Wheeler
Texoma Community Center	Cooke, Fannin, Grayson
Tri-County Services	Liberty, Montgomery, Walker
Tropical Texas Behavioral Health	Cameron, Hidalgo, Willacy
West Texas Centers	Andrews, Borden, Crane, Dawson, Fisher, Gaines, Garza, Glasscock, Howard, Kent, Loving, Martin, Mitchell, Nolan, Reeves, Runnels, Scurry, Terrell, Terry, Upton, Ward, Winkler, Yoakum

Source: Texas Council of Community Centers.

LOCAL AUTHORITY RESPONSIBILITIES

Local authorities have two primary responsibilities: authority functions and provider functions. DADS contracts with local authorities to provide authority functions. Local authorities also provide direct services in several Medicaid and non-Medicaid programs. Because of the relationship between some authority and provider functions, and a potential for conflicts of interest to arise, DADS requires local authorities to maintain administrative and fiscal structures to separate the authority and provider functions.

Two documents identify the authority functions local authorities are required to perform: the performance contract (primary contract) and a separate Medicaid provider agreement for the provision of Mental Retardation Service Coordination (herein service coordination). **Figure 2** shows required authority functions.

In addition to their authority functions, local authorities also provide direct services to consumers in various Medicaid and non-Medicaid programs. They offer a variety of HCS, TxHmL, and ICF/IID services, and contract to be case management agencies in the Community Living Assistance and Support Services (CLASS) 1915(c) Medicaid waiver, Program for All-Inclusive Care for Elderly (PACE) providers, and providers of Early Childhood Intervention services. Local authorities follow the same contractual requirements as other providers in these programs and are they are paid for providing services at the same rates used for other providers. Local authorities have also developed programs such as autism services for non-Medicaid clients using a variety of funding sources including General Revenue Funds and third-party payments.

FIGURE 2
REQUIRED AUTHORITY FUNCTIONS OF LOCAL AUTHORITIES, FISCAL YEAR 2012

FUNCTION	DUTIES
Community Living Options Information Process (CLOIP)	The 13 local authorities with an SSLC in their service area are required to inform residents of institutions and their legally authorized representatives (LARs) about all of the services and supports available to them in both institutional and community settings at least once per year before the individual's annual planning meeting occurs. When meeting with residents and their LARs, local authorities are required to distribute and explain materials developed by DADS and offer the opportunity to visit community living settings. The local authority is also required to attend each individual's annual planning meeting in person or via teleconference. An addendum to the Performance Contract is included for the 13 Local authorities responsible for CLOIP.
Ensuring an individual's access to services and supports by conducting intake, eligibility, and enrollment activities.	Local authorities serve as the point of entry for publicly funded IDD programs. They are entrusted with screening persons to determine a need for services, assessing eligibility, and enrolling eligible individuals into select Medicaid programs, depending on the availability of funding and services. These programs include the Intermediate Care Facilities for Individuals with Intellectual Disabilities (ICF/IID) program, which includes SSLCs and privately operated ICFs/ID; the Home and Community-based Services (HCS) 1915(c) Medicaid waiver; and the Texas Home Living (TxHmL) 1915(c) Medicaid waiver. Local authorities also provide information and refer persons to other programs as needed as part of DADS' "no wrong door" approach to serving consumers.
Performing "safety net" functions and ensuring the provision and oversight of General Revenue-funded services.	These services include: community support (habilitation, transportation); respite; employment assistance; supported employment; behavioral support; nursing; specialized therapies (i.e., social work; counseling; occupational, speech, and physical therapies; audiology; dietary services; and behavioral health services); vocational training; day habilitation; and some residential services. Local authorities may provide services directly or contract with private providers for their provision. Local authorities also have responsibilities as providers of last resort to provide continuity of care for consumers if their private provider ceases operations. As providers of safety net services, local authorities serve persons of all levels of need and intellectual disability. Many of the consumers receiving these services are waiting to receive other more robust community-based services such as those available in the TxHmL and HCS waivers.
Conducting service coordination.	Service coordination (sometimes referred to as case management) is a service that assists clients in gaining access to necessary medical, social, educational, and other services to improve their quality of life and increase community participation. Local authorities provide service coordination to four primary groups of clients: Medicaid clients who receive no General Revenue-funded or waiver services, General Revenue service recipients, and individuals enrolled in the HCS and TxHmL waivers. The Centers for Medicare and Medicaid Services (CMS) also approved provision of service coordination for certain populations (i.e., persons transitioning out of SSLCs or large private ICFs/ID, persons undergoing Preadmission Screening and Resident Review) for up to 180 days.
Conducting planning for the local service area.	This planning includes ensuring involvement by a local advisory committee and other stakeholders.
Protecting the rights of an individual.	Local authorities are required to explain to consumers their rights. Each local authority must have a Quality Management Plan which requires the local authority to document how it will improve the consumer rights protection process and assess and improve the process for reviewing rights restrictions.

Source: Department of Aging and Disability Services.

DADS OVERSIGHT OF LOCAL AUTHORITIES

The statutory approach to overseeing and financing local authorities historically has allowed for flexibility and local control. The contracts and administrative rules outline requirements for local authorities to follow, but otherwise provide for flexibility at the local level. The payment methodology reinforces this flexibility; local authorities are paid using quarterly lump-sum payments tied to their service targets instead of other methodologies such as fee-for-service. Since the consolidation of the health and human services agencies following the Seventy-eighth Legislature and formation of DADS, the agency has continued to allow for local control.

In addition to defining of the primary responsibilities of local authorities, key components of the performance contract include service targets for each local authority, performance requirements, and provision of administrative and financial remedies for noncompliance. The service targets are tied to appropriations levels and are based on historical service levels in a particular area. Since appropriations for the 2012–13 biennium were reduced, the targets were also reduced. **Figure 3** shows the service targets by local authority for fiscal years

FIGURE 3
SERVICE TARGETS BY LOCAL AUTHORITY, FISCAL YEARS 2010 TO 2013

LOCAL AUTHORITY	2010	2011	2012	2013
Anderson-Cherokee	118	118	87	81
Andrews	132	132	97	90
Austin-Travis County	340	340	239	222
Betty Harwick	88	88	62	58
Bexar MRA	393	393	276	256
Bluebonnet Trails	311	311	230	214
Border Region	116	116	86	80
Brazos Valley	100	100	70	65
Burke Center	87	87	61	57
Camino Real	95	95	70	65
Center for Life Resources	59	59	44	41
Central Counties	142	142	105	98
Central Plains	58	58	43	40
Coastal Plains Center	141	141	104	97
Community Healthcore – Sabine Valley	142	142	105	98
Concho Valley	69	69	48	45
Dallas Metrocare Services	898	898	663	616
Denton County	192	192	145	135
El Paso Center	187	187	131	122
Gulf Bend	39	39	29	27
Gulf Coast	197	197	145	135
Harris County	1,157	1,157	854	793
Heart of Texas	162	162	114	106
Helen Farabee Center	119	119	88	82
Hill Country	205	205	151	140
Lakes Regional	229	229	169	157
LifePath Systems	129	129	95	88
Lubbock	132	132	93	86
Nueces County	73	73	51	47
Pecan Valley	73	73	54	50
Permian Basin	108	108	80	74
Spindletop	303	303	224	208
Tarrant County	741	741	547	508
Texana	258	258	181	168
Texas Panhandle	257	257	190	177
Texoma	81	81	60	56
Tri-County	162	162	120	111
Tropical Texas	222	222	156	145
West Texas Center	109	109	80	74
Total	**8,424**	**8,424**	**6,147**	**5,711**

Source: Department of Aging and Disability Services.

2010 to 2013. According to DADS, since it assumed oversight of local authorities, all have met their service targets. Local authorities were required to serve an average of 8,424 persons per month in fiscal years 2010–11 with their allocation of General Revenue Funds. Local authorities reported serving an average of 12,741 and 12,433 consumers per month, in fiscal years 2010 and 2011, respectively.

The contract also includes some key performance measures and outcomes all local authorities must meet, shown in **Figure 4**. According to DADS, it has pared back the measures collected over time. Local authorities also perform additional tasks that are not tied to performance measures.

FIGURE 4
PERFORMANCE MEASURES AND OUTCOME TARGETS IN PERFORMANCE CONTRACT, FISCAL YEARS 2012 AND 2013

PERFORMANCE MEASURE	OUTCOME TARGET
Percent of all enrollments into HCS that meet timelines specified in Attachment K.	At least 95% for each quarter
Percent of permanency plans completed that meet timeline requirements specified in Attachment S.	At least 95% for each quarter
Percent of all enrollments into TxHmL that meet timelines specified in Attachment K.	At least 95% for each quarter
Percent of HCS interest list population contacted for biennial review as required in Attachment J, Section I.	At least 50% by end of fiscal year 2012 At least 100% by end of fiscal year 2013

Source: Department of Aging and Disability Services.

The contract contains remedies and penalties DADS may use to correct non-compliance. Penalty amounts range from $1,000 to $18,000 per sanction and are tied to the size of the local authority's annual allocation.

To ensure compliance with the contract, DADS is statutorily required to use program and financial audits to evaluate the performance of local authorities. The DADS Contract Accountability and Oversight Unit performs annual on-site reviews of all local authorities. These reviews examine a local authority's performance across its contractual duties, including authority duties related to the HCS waiver, TxHmL waiver, services funded by appropriations of General Revenue Funds, and CLOIP, when applicable. DADS staff gathers information through record reviews and interviews of consumers and legally authorized representatives (LARs). Staff may also review other documentation and processes such as planning and advisory board meeting minutes, staff credentials, and interest list records, and evaluate a local authority's progress in addressing deficiencies identified in past reviews. At the end of the visit, an exit conference occurs and DADS provides the local authority with a report of findings. For any deficiencies, a corrective action plan is required within 30 days, with a 10-day period provided for appeal. These visits do not evaluate the performance of local authorities as service providers in various programs (i.e., HCS or TxHmL waivers). DADS Regulatory Services staff examine local authority performance separately.

DADS also has processes for financial monitoring of local authorities. The agency developed these processes in response to an August 2006 report by the State Auditor's Office that highlighted the absence of a financial monitoring process. Each local authority is required to submit quarterly financial reports, an annual financial report, and an annual single audit. DADS uses a risk assessment process to identify local authorities to visit for more intensive on-site financial reviews. The risk assessment process assigns a level of risk ranging from low to high to each entity. Any local authority with moderate or high risk is visited in a given year (approximately 15 visits per year). A local authority could be identified as high risk if it has experienced cash flow problems, previous periods of state management, service deficiency issues, or financial management issues that resulted in a need for monthly financial reporting to DADS.

According to DADS, it commonly places local authorities on corrective action plans following a quality assurance or financial review. Typically, DADS provides technical assistance to correct the situation, but assesses fines in situations that are more serious. According to DADS, it assessed $91,000 and $24,000 in penalties in fiscal years 2010 and 2011, respectively.

LOCAL AUTHORITY FINANCE

According to quarterly financial reports provided by local authorities to DADS, community centers (including both local authorities and local mental health authorities) received approximately $1.2 billion from all revenue sources in fiscal years 2010 and 2011, and expended approximately $1.1 billion each year (see **Figure 5**). **Figure 6** shows all IDD revenue and expenditures in fiscal years 2010 and 2011. IDD programs provided by local authorities comprise approximately 28 percent of community centers' revenue and 30 percent of expenditures. **Figure 7** shows IDD revenue by source for fiscal years 2010 and 2011.

FIGURE 5
ALL REVENUE AND EXPENDITURES FOR COMMUNITY CENTERS, FISCAL YEARS 2010 AND 2011

FISCAL YEAR	REVENUE (IN MILLIONS)	EXPENDITURES (IN MILLIONS)
2010	$1,201.2	$1,063.4
2011	$1,231.6	$1,084.6

Note: Revenue and expenditures include mental health and IDD-related revenue and expenditures.
Source: Legislative Budget Board.

FIGURE 6
IDD REVENUE AND EXPENDITURES FOR LOCAL AUTHORITIES, FISCAL YEARS 2010 AND 2011

FISCAL YEAR	REVENUE (IN MILLIONS)	EXPENDITURES (IN MILLIONS)
2010	$338.8	$327.2
2011	$345.0	$329.0

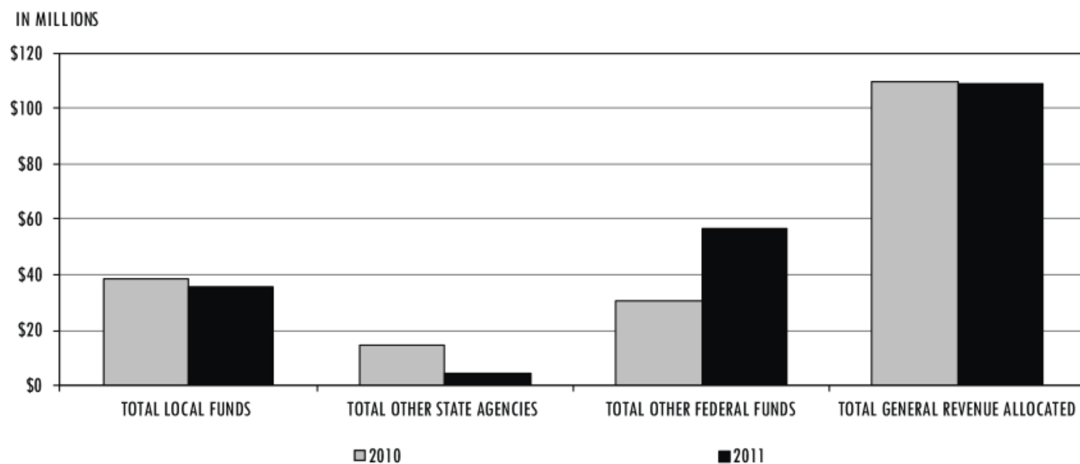
Source: Legislative Budget Board.

Local authorities receive funding from a variety of sources, including state, federal, and local governments. The proportion of funding from each of these sources is shown in **Figure 7**. A portion of funds under Strategy A.1.1 (Intake, Access, and Eligibility) of DADS' budget is provided to local authorities. In addition, all of Strategy A.4.2 (Intellectual Disability Community Services, formerly known as MR Community Services) is provided to local authorities. The combined allocation of General Revenue Funds for fiscal years 2010 to 2013 provided to local authorities for authority functions is shown in **Figure 8**.

In the fiscal years 2014–15 biennium, structure changes to DADS' budget facilitate identification of funding to local authorities and consolidate funding for administrative functions and direct services into two strategies. A new sub-strategy is included in A.1.1 for local authorities and includes appropriations for service coordination (Medicaid and General Revenue funded-clients), assessment and eligibility determination, permanency planning, local authority program administration, and CLOIP. This moves funds for service coordination, permanency planning, and CLOIP from A.4.2 to A.1.1. Funds remaining in A.4.2 are for safety net services. In addition to existing sub-strategies for current services (ID community services, employment services, day training services, therapies, respite, independent living, and ID community services residential), a new sub-strategy is included for crisis services.

In addition to these structure changes, new performance measures identify the number of persons served and average cost by activity: service coordination and each of the individual safety net services. Collectively, these structure and measure changes increase transparency about funds appropriated to local authorities, group appropriations for similar functions, and result in more precise performance measures to capture the impact of each function performed by local authorities.

FIGURE 7
LOCAL AUTHORITY IDD REVENUE BY SOURCE, FISCAL YEARS 2010 AND 2011



Notes: Revenue amounts provided by local authorities via quarterly Report IIIs. General Revenue Funds allocated sums refer to actual amounts received not DADS' original allocation.
Source: Legislative Budget Board.

FIGURE 8
TOTAL LOCAL AUTHORITY ALLOCATIONS OF STATE GENERAL REVENUE FUNDS, FISCAL YEARS 2010 TO 2013

(IN MILLIONS) LOCAL AUTHORITY	2010	2011	2012	2013
Anderson-Cherokee	$1.4	$1.4	$1.0	$0.9
Andrews Center	1.8	1.8	1.2	1.2
Austin-Travis County	4.1	4.1	3.0	2.8
Betty Hardwick (Abilene)	1.4	1.4	1.0	1.0
Bexar MRA	5.5	5.4	3.7	3.5
Bluebonnet Trails	3.6	3.6	2.6	2.4
Border Region	2.0	2.0	1.5	1.4
Brazos Valley	1.5	1.5	1.1	1.1
Burke Center	1.6	1.6	1.1	1.1
Camino Real	1.9	1.9	1.4	1.3
Center for Life Resources	0.7	0.7	0.5	0.5
Central Counties	1.8	1.8	1.3	1.2
Central Plains	0.7	0.7	0.5	0.5
Coastal Plains Center	1.8	1.8	1.3	1.2
Community Healthcore - Sabine Valley	1.8	1.8	1.3	1.2
Concho Valley	1.0	1.0	0.7	0.7
Dallas MetroCare Services	10.1	10.1	7.1	6.6
Denton County	3.0	3.0	1.8	1.7
El Paso Center	2.7	2.7	1.8	1.7
Gulf Bend	0.5	0.5	0.3	0.3
Gulf Coast	2.5	2.5	1.8	1.7
Harris County	13.1	13.1	8.8	8.2
Heart of Texas	2.2	2.2	1.6	1.5
Helen Farabee Center	1.5	1.5	1.1	1.0
Hill Country	2.5	2.5	1.8	1.7
Lakes Regional (includes Hunt Co.)	2.8	2.8	2.0	1.9
LifePath Systems	1.7	1.7	1.2	1.1
Lubbock	1.7	1.7	1.2	1.1
Nueces County	1.2	1.2	0.8	0.8
Pecan Valley	0.9	0.9	0.7	0.6
Permian Basin	1.3	1.3	0.9	0.8
Spindletop	4.4	4.4	3.3	3.0
Tarrant County	8.7	8.8	6.2	5.7
Texana	3.9	3.9	2.8	2.7
Texas Panhandle	4.5	4.5	3.2	3.0
Texoma	1.0	1.0	0.7	0.7
Tri-County	2.3	2.3	1.7	1.5
Tropical Texas	3.6	3.6	2.4	2.2
West Texas Center	1.4	1.4	1.0	0.9
Total	**$110.1**	**$110.1**	**$77.3**	**$72.2**

Notes: In fiscal years 2010 and 2011, the total allocations include the General Revenue Funds, one-time payment for HCS rollout, In-home and Family Support, Permanency Planning, and CLOIP funds. In fiscal years 2012 and 2013, the total allocation includes General Revenue Funds, Permanency Planning, and CLOIP funds.
Source: The Department of Aging and Disability Services.

The amount of General Revenue Funds allocated to each local authority is tied to historical funding levels and is related to the service targets they are required to meet. The service targets include persons expected to receive service coordination (state-funded) and persons expected to receive General Revenue-funded services.

In addition to this amount, local authorities receive state and Federal Funds for the programs in which they serve as providers. This includes Medicaid programs in which local authorities provide service coordination (TxHmL and HCS) and programs in which local authorities are service providers (e.g., HCS, TxHmL, ICF/IID, PACE, CLASS, ECI). It is difficult to isolate these amounts because they are reflected within the budget appropriation for each program.

Some local authorities have greater access to Local Funds than others do. Local Funds include, at a minimum, the funds the entities are required to contribute to their programming that serves as a match for state funds. These funds may come from a variety of sources (i.e., county, city, hospital district, school district, or program income). Some entities have raised revenue in excess of this requirement. **Figure 9** and **Figure 10** show the 10 local authorities with the greatest amount of Local Funds above the required match in fiscal years 2010 and 2011.

FIGURE 9
TEN LOCAL AUTHORITIES WITH THE GREATEST LOCAL FUNDING ABOVE THE REQUIRED MATCH
FISCAL YEAR 2010

LOCAL AUTHORITY	FUNDING ABOVE THE REQUIRED MATCH (IN MILLIONS)
Harris County	$3.0
Tarrant County	2.6
Camino Real MHMR	2.5
Andrews	2.1
Spindletop	1.7
Concho Valley	1.4
Nueces County	1.1
Texana	1.1
Lubbock	1.1
Lakes Regional	1.0
Total, Top 10	**17.6**
Total, All Local Authorities	**$29.8**

Note: Local Funds include program income and other local funding.
Source: Local Authorities.

FIGURE 10
TEN LOCAL AUTHORITIES WITH THE GREATEST LOCAL FUNDING ABOVE THE REQUIRED MATCH
FISCAL YEAR 2011

LOCAL AUTHORITY	FUNDING ABOVE THE REQUIRED MATCH (IN MILLIONS)
Camino Real MHMR	$2.3
Texana	2.1
Harris County	2.0
Bluebonnet Trails Community MHMR	1.8
Andrews	1.7
Tarrant County	1.4
El Paso Center	1.1
Concho Valley	1.1
Spindletop	1.0
Tropical Texas	0.9
Total, Top 10	**15.5**
Total, All Local Authorities	**$27.0**

Note: Local Funds include program income and other local funding.
Source: Local Authorities.

EVOLUTION OF LOCAL AUTHORITY RESPONSIBILITIES

Since their formation in 1965, local authorities and their roles have evolved as service delivery for persons with IDD has changed. Local authorities were originally primarily service providers, but today are responsible for both authority and provider functions. Local authorities were once the only publicly funded alternative to institutional care, but today they are one of several alternatives. The level of state-delegated responsibilities has also ebbed and flowed over time, with several recent legislatures choosing to expand the responsibilities of local authorities.

In Texas, from the 1960s until the mid-1990s, the role of local authorities was primarily to provide services. At the time, community centers were authorized under federal law and institutional care was the primary mechanism for the provision of publicly funded programs for persons with IDD. The federal government created community centers as the first community alternative to institutional care, predating creation of the Medicare and Medicaid programs in 1965, and before the emergence of 1915(c) waivers, which were authorized in 1981 and whose enrollment nation-wide has grown each decade since their inception (from 35,077

enrollees in 1989 to 261,788 enrollees in 1999, to 562,067 enrollees in 2009).

The settlement of the *Lelsz v. Kavanagh* lawsuit, a lawsuit filed against the state to challenge the quality of care provided in three state schools that took 21 years of court supervision to resolve, affected local authorities in several ways. Some local authorities took on the responsibility to transition a significant number of consumers from institutional to community care. The settlement also led to a distinction between the authority and provider roles. To codify practices already put in place to comply with the *Lelsz* settlement, the Seventy-fourth Legislature, 1995, passed House Bill 2377. House Bill 2377 was the first time statute began to separate authority and provider functions. It also resulted in the development of pilot initiatives to test delegation of certain state functions to local authorities.

In 1998, TDMHMR initiated the Mental Retardation Local Authority (MRLA) waiver initiative at three pilot sites. This initiative sought to test an alternative to managed care by using local authorities to perform person-directed planning, cost containment of the HCS program, and oversight through delegation of state responsibilities. Under this initiative, the responsibilities of local authorities included service coordination, network planning, provider surveys, and management of resources (utilization review). TDMHMR later decided to expand the program, with full statewide implementation scheduled for September 2003.

Before full statewide expansion, the Seventy-eighth Legislature, 2003, enacted several related provisions in the omnibus Health and Human Services reform bill, House Bill 2292. These changes included:

- creation of DADS and the Department of State Health Services, which separated oversight of mental health and IDD services;
- privatization of HCS waiver services and the intent to limit service provision of local authorities to instances in which they would serve as a "provider of last resort;"
- transfer of the function of service coordination (case management) to private HCS providers; and
- transfer of some of the delegated functions such as utilization review from local authorities to the newly created DADS.

After passage of House Bill 2292, DADS eliminated the MRLA initiative. Due to concerns from some consumers/families and advocates about the need for a publicly operated service option, some tempering of the House Bill 2292 language occurred in subsequent legislative sessions. The Texas Council of Community Centers and the Private Providers' Association (PPAT) developed an agreement to clarify the role of local authorities to continue providing services but also to limit this service provision by requiring local authorities to make a good faith effort to build provider networks. Legislation to codify the agreement was vetoed by the Governor in 2005, but was enrolled following the Eightieth Legislature, 2007, in House Bill 2439. The bill capped the level of HCS and TxHmL services local authorities could provide to August 31, 2004 enrollment levels. According to DADS, as of October 31, 2011, 21 local authorities are temporarily operating above their August 31, 2004 HCS cap and all but four are temporarily operating above their TxHmL cap. According to DADS, the number of providers operating above the TxHmL could be attributed to the current refinancing of consumers receiving state-funded services to the TxHmL waiver.

Recently, the authority roles of local authorities have expanded due to policy and budget decisions. In the Eightieth Legislature, 2007, Senate Bill 27 transferred administration of CLOIP to local authorities to address potential institutional bias in the delivery of the information by state staff. A second expansion of local authority responsibilities occurred during the Eighty-first Legislature, 2009. Section 48 of Article II Special Provisions of the 2010–11 General Appropriations Act transferred the responsibility for service coordination from HCS waiver providers to local authorities. This change was effective June 1, 2010. Factors related to this change included a desire to address a potential conflict of interest on the part of HCS providers by separating service provision from the planning process by providing consumers with access to an independent third-party provider.

MAJOR ISSUES AFFECTING LOCAL AUTHORITIES

Challenges confronting the local authority system stem from recent budget and policy decisions of the Legislature as well as changing needs of consumers. Major budget and policy issues include providing service coordination for HCS clients, refinancing state-funded clients into TxHmL, and adjusting service provision based on budget reductions of General Revenue Funds, and building capacity to address crisis services.

SERVICE COORDINATION TRANSITION

The policy decision to transfer service coordination in fiscal year 2010 for HCS consumers from private providers to local authorities required significant effort from DADS, local authorities, and private providers to implement, and many unresolved issues remain, making it difficult to assess the outcomes of the change.

To prepare for the change, DADS drafted rules that distinguished between the responsibilities of local authorities and private HCS providers. DADS also developed the first HCS handbook to provide further detail on these responsibilities and conducted trainings for local authority and private provider staff. DADS provided approximately $9.6 million in transfer funds to enable local authorities to hire staff before the transition (and before the period in which they could begin billing). As local authorities and private providers encountered difficulties in the implementation, DADS provided technical assistance and also established regular stakeholder conference calls to provide a forum to address concerns as they emerged.

Local authorities also had to make significant preparations for the transition. To prepare to take on service coordination for the over 18,000 consumers in the HCS program, local authorities had to secure space, hire and train staff, collect client documentation and build medical charts, conduct outreach to consumers and their families, and establish relationships with providers in their service area.

Private providers also encountered challenges leading up to and after the June 1, 2010 transition. Because they did not know the extent to which their responsibilities would change until rule development, and in some instances, actual implementation, providers responded to the transition differently. Some lost or reduced staff in anticipation of the change, while others chose not to reduce staff. Initial confusion regarding the provider and local authority roles in the person-centered planning process and variations in interacting with different service coordinators compounded the concerns of private providers.

In assessing the outcomes of the transition, several ongoing issues remain, including whether the change alleviated the conflict of interest, resulted in more cost-containment in the HCS program, and resulted in a reimbursement methodology that adequately compensates private providers and local authorities.

In transferring case management from HCS providers to local authorities, the intent was to reduce the potential for a conflict of interest to arise between the entity providing services and the entity leading service planning for a consumer. The planning process involves identifying services and the number of hours needed, and the provider could benefit if the amount of utilization increased. Provider organizations have argued that because local authorities are also service providers in the HCS program, the change did not fully separate service coordination from service provision. In addition, they have argued that because local authorities are entrusted with informing consumers of provider options and enrolling consumers into the HCS waiver, that local authorities have an unfair self-promotion advantage. Local authorities have contended that the conflict of issue has been resolved previously. Statute has defined and prior legal precedent has established that a local authority is an agency of the state, a governmental unit, and a unit of local government," and therefore, due to the state-action exemption in anti-trust law, there can be no conflict between duties local authorities are asked to perform. DADS has sought to mitigate concerns by requiring in the performance contract that local authorities use different staff in performing service coordination and service delivery.

There is some evidence, including data from DADS and interviews with local authorities, that HCS consumers have sought more changes to their plans of care since the transition of service coordination to local authorities, suggesting that access to information from local authority service coordinators could be helping consumers to make decisions more in line with their preferences. Data from DADS indicates that transfers between providers in the same region have increased each year since fiscal year 2009 (from 1,513 in fiscal year 2009 to 1,952 in fiscal year 2011). The month prior and month following the service coordination transition had the highest number of transfers in that period, except July 2011, and according to DADS, transfers later tapered off. Some of this increase can be attributed to the increase in individuals enrolled in the program, but some of it could also be linked to the service coordination change. There has also been an increase in consumers choosing to manage their own care through Consumer Directed Services (CDS) from fiscal year 2009 (a monthly average of 46 consumers) to fiscal year 2011 (a monthly average of 174 consumers). However, some of this increase could be attributed to DADS' efforts to expand consumer take-up of the CDS option. In some areas, consumers moved between residential options (i.e., from residing in a group home to a foster care arrangement). Although it is not possible to establish a causal link between the policy change and these outcomes, this evidence suggests

a relationship may exist between local authority staff performing service coordination and changes in consumers' individual plans of care.

Another way to evaluate whether the policy change was effective is to consider how the change affected the utilization of services in the HCS program. However, it is not yet possible to determine whether the change has improved cost control in the HCS program because data are not yet available for analysis. If it is true that HCS providers had a conflict of interest in overseeing service planning and providing services, and that the conflict of interest resulted in increased utilization of services, it is reasonable to expect that moving the provision of service coordination to a third-party could reduce or contain growth in utilization. However, because all HCS clients had active service plans in place at the time of the transition and plans have a one-year lifespan, it was not until June 1, 2011 that all HCS consumers had new individual plans of care whose development was overseen by service coordinators employed by local authorities. As more data becomes available through the end of fiscal year 2012, it may be possible to determine whether the transition of service coordination affected service utilization.

Another outstanding issue is the adequacy of compensation local authorities and HCS providers receive for performing service and program coordination. It is also unknown how much the state spends on service coordination for the HCS waiver program. Methodology changes in the rates for both entities make it difficult to determine the net state spending on this service now and compare that to spending before June 1, 2010.

Following the change in the provision of service coordination, the Health and Human Services Commission (HHSC), the agency charged with setting rates for acute and long-term care Medicaid programs, was directed to shift 80 percent of the monthly case management rate previously paid to HCS providers to local authorities. Twenty percent of the rate was intended to be retained by HSC providers as compensation for ongoing day-to-day program coordination activities (e.g., transportation, scheduling of providers, and working with consumers/families to implement the individual plans of care).

When HHSC adopted a new rate for service coordination provided by local authorities (which took effect June 1, 2010), the rate increased from what had been used to reimburse local authorities for providing service coordination to TxHmL, state-funded and other select Medicaid clients. However, at CMS' direction, the reimbursement model changed in September 2011 from a flat-rate to an encounter-based system that reimburses differently for in-person and telephone contacts. It is not yet possible to assess the fiscal impact to the state of the methodology change, or determine whether local authorities are recovering their full costs, given the recent implementation.

Regarding compensation for HCS providers, it is also difficult to assess whether the 20 percent of the original rate still exists to pay providers for program coordination. After the transfer of service coordination to local authorities, HHSC redistributed the amount reflecting 20 percent of the original case management rate across the direct and indirect portion of the rates for other HCS services. This methodology change was based on direction from CMS that the state could no longer use a flat monthly rate for service coordination. This change also coincided with major revisions to how HCS providers are paid for administrative functions (also a directive from CMS), which further obscures the impact. In addition, in the Eighty-second Legislature, 2011, rate reductions in the HCS program were incurred and these reductions could have eliminated the 20 percent intended to compensate HCS providers for case management.

Aside from whether the 80 percent of the case management rate intended for local authorities and 20 percent intended for private HCS providers were realized by either group, a separate question remains in terms of the adequacy of these amounts. The actual provision of service coordination by local authorities and program coordination by HCS providers has been different than anticipated before the change. The service coordination role taken on by local authorities is distinct from the case management HCS providers used to provide. This service coordination, is a higher level of coordination intended to meet consumers' needs and to help consumers access any services for which they desire and need, not just those within the HCS program. Although many anticipated losing more of their responsibilities in the transition, HCS providers have retained most of their program coordination functions, requiring providers to retain or rehire staff. The methods providers are using to pay for these staff vary and raise questions about the adequacy of reimbursement for this function.

REFINANCING OF CLIENTS INTO TXHML

Since at least 1997, riders in TDMHMR and later DADS' bill patterns in the General Appropriations Act have directed

the agencies to refinance eligible clients receiving services financed by General Revenue Funds into Medicaid programs, which have matching Federal Funds. According to reports by DADS, in recent years, this practice resulted in the transfer of a small number of clients between programs (5 in fiscal year 2006, 25 in 2008 in fiscal year 2008, and 4 in fiscal year 2009). In the General Appropriations Act, Eighty-second Legislature, 2011, Rider 45 directed DADS to refinance services on a much larger scale. DADS was authorized to refinance up to 5,000 Medicaid-eligible individuals from state-funded services to TxHmL. In total, DADS estimates that approximately 4,200 clients were refinanced by November 2011. DADS directed local authorities to determine if refinancing was appropriate for clients based on a comparison between the cost (General Revenue Funds) to serve them in current programs and the state's share of the average annual TxHmL cost (a maximum of $7,043). Clients already receiving that level of state-funded services or greater were to be considered for refinancing. According to the Texas Council of Community Centers, local authorities were then directed on several occasions to reduce the cost threshold for persons in order to reach 4,200 persons to refinance.

From a consumer perspective, the refinancing resulted in many individuals gaining access to a richer package of services and supports than the state-funded services they were previously able to receive from local authorities. Although the amount of services accessed by individuals varies across local authorities, several local authorities use monthly or annual caps on services an individual can receive. For example, Austin Travis County Integral Care caps services at between $200 and $500 per month. The Alamo Area Council of Governments uses an annual cap of $2,000 for children and $4,000 for adults. Refinanced individuals could access more of the services they were receiving and some additional services. These additional services may not have been available because they were not mandatory General Revenue-funded services or because the individuals had higher priority needs that exhausted the resources allowed under their service cap.

From the state's perspective, refinancing results in less fiscal certainty than continuing to serve clients by using General Revenue Funds. Because the federal government requires states to offer comparable services to all 1915(c) waiver enrollees, the state cannot limit the types of services available to a person once that person is enrolled in the waiver. For example, if a consumer had only been receiving respite services funded by General Revenue Funds but was later enrolled in TxHmL, the state could not limit service provision for that individual to only respite services, as long as other waiver enrollees had access to other services. As an enrollee in TxHmL, that person may access as much of each allowable service as is deemed appropriate through the person-centered planning process, up to the annual cost limit for all consumers in the waiver. This amount was $17,000 in fiscal year 2012. One potential scenario for increased costs to the state would be if a consumer receiving $1,000 in General Revenue-funded respite services annually enrolled in TxHmL and received a package of services costing $17,000. The state's share of this cost would be $7,043, approximately $6,000 more than the state was paying previously to serve the client. The extent to which utilization could increase for refinanced clients is unknown because their full needs may not have been assessed when they were receiving General Revenue-funded services. Although the state and federal government would share in new costs of serving a former state-funded client in the TxHmL waiver, it is possible the state's total spending will increase because of refinancing.

REDUCTION OF GENERAL REVENUE FUNDS

A second budget decision from the Eighty-second Legislature that has significantly affected local authorities was a 26.7 percent reduction in the appropriation of General Revenue Funds from fiscal years 2011 to 2012 to DADS to be used for local authorities. General Revenue Funds allocated by DADS to local authorities for General Revenue-funded services only (excluding funds for In-Home Services and Supports, CLOIP, and Permanency Planning) was $99.4 million each year for fiscal years 2010 and 2011. The fiscal year 2012 allocation was $72.9 million. An additional reduction of General Revenue Funds occurred with the zero-funding of the In-Home Services and Supports program, which local authorities distributed to consumers as grants to fund up to $2,500 in services, special equipment and home modifications, transportation, and other selected items. This program had received $5.7 million in General Revenue Funds in fiscal years 2009 to 2011.

The reduction of General Revenue Funds to local authorities resulted in challenges for them, despite the fact that this funding comprises only approximately one-third of IDD revenue. General Revenue Funds are the most flexible funds for local authorities. They use these funds to meet their service targets, but they do so in different ways. Some use the funds to serve persons who would not be otherwise Medicaid eligible. Others use them to develop specialty programs, such as the autism partnership Austin-Travis County Integral

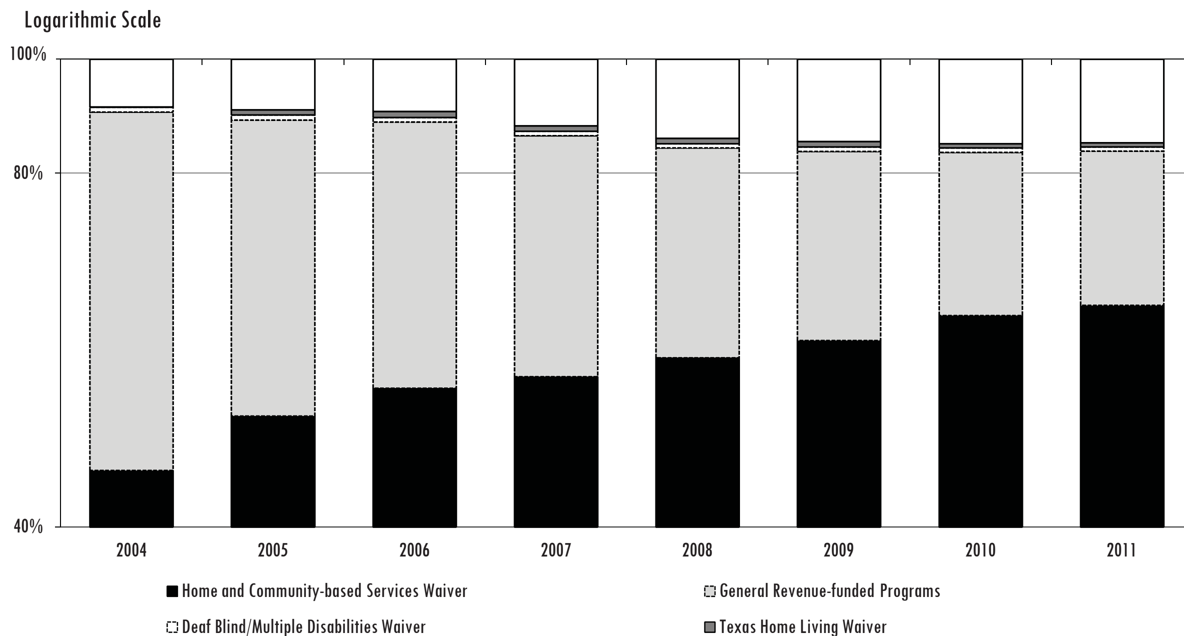
Care developed with a local higher educational institution. Local authorities responded to the reduced funding in various ways. Some reduced the annual/monthly consumer budgets. Others tried to shield consumers from the impact and reduced their staff. Some reduced the availability of certain services (e.g., day habilitation available three times per week instead of five). According to the Texas Council of Community Centers, the consumer impact varied. As of March 1, 2012, 911 consumers who had been receiving In-Home Services and Supports were refinanced into TxHmL, 754 were enrolled in General Revenue Community Services, and 812 were unable to be served in existing programs (although it is possible some of these persons still received service coordination).

The recent reduction in General Revenue Funds is part of a greater pattern of reduced appropriations for local authorities relative to community-based Medicaid programs. Appropriations for local authorities remained relatively flat from fiscal years 2005 to 2011 and then decreased in fiscal year 2012. During this time, appropriations for 1915(c) Medicaid waiver programs serving persons with IDD have increased significantly due to consumer preferences and the state's desire to maximize available funding by drawing down Federal Funds. The decision to transfer 4,200 clients into the TxHmL program further underscores the intent of the Legislature to maximize the use of Federal Funds. Although local authorities were established as the first alternative to institutional care, today, other alternatives exist and, as a result, the share of services provided by local authorities has eroded. **Figure 11** shows the share of spending on community-based care for persons with IDD attributed to General Revenue-funded programs and the four Medicaid 1915(c) waivers. **Figure 12** shows total Community IDD Spending by program.

BUILDING CAPACITY FOR CRISIS SERVICES

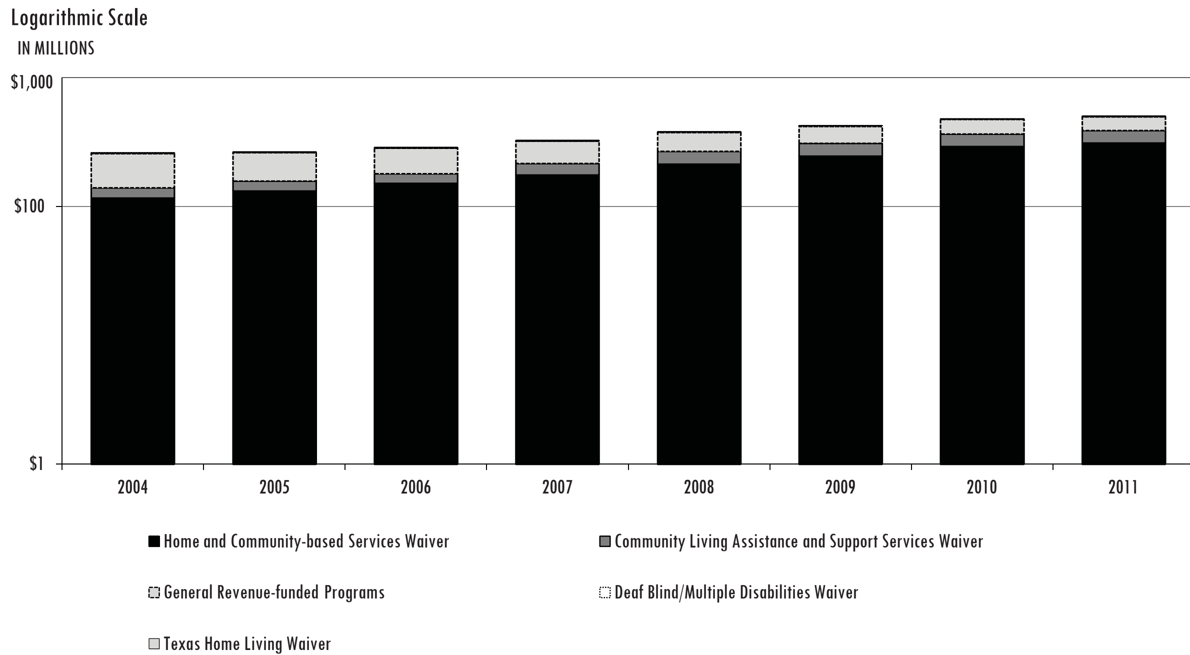
According to the Texas Council of Community Centers, despite changes in funding priorities, demand for safety net services remains at the local level, particularly for crisis services which are intended to avoid more costly institutionalizations and keep consumers in the most integrated community setting. According to a 2012 survey of local authorities, local authorities anticipate spending an average of $295,243 on crisis services in fiscal year 2013 or

FIGURE 11
COMMUNITY IDD GENERAL REVENUE SPENDING BY PROGRAM, FISCAL YEARS 2004 TO 2011



Note: For fiscal years 2009 to 2011, the amounts provided for the four Medicaid 1915(c) waiver programs include American Recovery and Reinvestment Act of 2009 funding. This combined expenditure amount reflects what the General Revenue Fund expenditures would have been had the federal stimulus funding not been available.
Source: Legislative Budget Board.

FIGURE 12
TOTAL COMMUNITY IDD GENERAL REVENUE SPENDING BY PROGRAM, FISCAL YEARS 2004 TO 2011



NOTE: For fiscal years 2009 to 2011, the amounts provided for the four Medicaid 1915(c) waiver programs include American Recovery and Reinvestment Act of 2009 funding. This combined expenditure amount reflects what the General Revenue Fund expenditures would have been had the federal stimulus funding not been available.
SOURCE: Legislative Budget Board.

17.0 percent of their state funding (assuming an average General Revenue allocation of $1.7 million in fiscal year 2013). This average is skewed higher than most local authorities anticipate spending because three local authorities estimate a need to spend over $1.0 million on crisis services. Seven local authorities anticipate that they would expend at least one quarter of their state funding on crisis services. Despite this anticipated need and the priority local authorities are assigning to crisis services, according to the Texas Council of Community Centers, building capacity to provide crisis services is challenging for multiple reasons: the lack of psychiatric specialists and board-certified behavior analysts statewide, a lack of expertise of persons capable of serving consumers with both IDD and mental health needs, a lack of after-hours crisis intervention and stabilization services, and a lack of emergency respite options, among other issues. In response to this identified need, the fiscal years 2014–15 introduced General Appropriations Bill includes a sub-strategy in strategy A.4.2 for this purpose. While local authorities were permitted to use state funds for crisis services previously, carving them out into their own sub-strategy will enable tracking of funds expended for this purpose over time.

IMPROVE ASSESSMENT AND RESOURCE USE IN COMMUNITY PROGRAMS

Texas offers individuals with intellectual and developmental disabilities a continuum of services including safety net services delivered by local authorities, four federal Medicaid 1915(c) waiver programs offering home and community-based services, and an entitlement program offering institutional services. The current system of service provision maximizes budget certainty for the state but does not control the over- and under-provisioning of services. In addition, demand for community services exceeds the availability of services, despite significant expansion of the waiver programs. While many other states rebalanced their long-term care service and supports through savings achieved from deinstitutionalization, Texas continues to operate a dual-funded system of care. With this system, expansion of the number of persons served in community settings can only be funded by new appropriations or from cost savings achieved within existing programs. Using an improved assessment process across waivers could more precisely identify consumer needs and allow the state to implement a resource allocation initiative to ensure individuals receive the appropriate services. The state could use any cost savings gained from the initiative to serve more individuals on the interest lists. Information collected from the assessment tool could improve long-term planning of system services for persons with intellectual and developmental disabilities. The tool could also provide the information needed to assess the benefits and costs of various redesign proposals other states are considering.

FACTS AND FINDINGS

- ♦ Significant unmet need exists for the intellectual and developmental disability waiver programs; as of August 2012, the interest lists for these programs contained 104,330 individuals (this count is likely duplicated due to the fact that individuals may have signed on to multiple lists).
- ♦ The existing continuum of services for individuals with intellectual and developmental disabilities was developed to reinforce budget certainty. Consumers are stratified across programs based on how long they have been waiting for services and not based on their needs.
- ♦ The Home and Community-based Services waiver has grown from a waiver serving 30 clients in 1985, to one with 19,384 clients in fiscal year 2011.
- ♦ Other states are considering and implementing a variety of reforms to serve individuals with intellectual and developmental disabilities including consolidating waivers, implementing delivery system changes such as managed care, implementing new habilitation benefits made possible by the federal Affordable Care Act, and attempting to better match needs with resources.

CONCERNS

- ♦ The functional assessment processes and tools used across intellectual and developmental disability waiver programs are limited. Also, the needs of clients on the interest lists are not assessed. The lack of standard information about current client and interest list client needs makes it difficult to prioritize needs and engage in planning for the future of Texas' system of supports for persons with intellectual and developmental disabilities.
- ♦ The design of waiver programs for persons with intellectual and developmental disabilities does not ensure persons receive the services they need. A variety of factors may contribute to over- and under-provisioning of services.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Amend statute to require the Department of Aging and Disability Services to implement an automated functional assessment tool across state programs serving clients with intellectual and developmental disabilities and for persons on interest lists.
- ♦ **Recommendation 2:** Amend statute to require the Department of Aging and Disability Services to implement a resource allocation methodology in the Home and Community-based Services waiver program.
- ♦ **Recommendation 3:** Include a contingency rider in the introduced 2014–15 General Appropriation

Bill to provide $1.5 million in General Revenue Funds to the Department of Aging and Disability Services for implementation of an automated functional assessment tool and a resource allocation methodology.

- **Recommendation 4:** Include a contingency rider in the introduced 2014–15 General Appropriation Bill directing the Department of Aging and Disability Services, in collaboration with the Health and Human Services Commission, to submit a report to the Legislative Budget Board and the Governor by March 1, 2015 that summarizes information made available by the new assessment tool about the needs of consumers across waiver programs for persons with intellectual and developmental disabilities, quantifies the values of any adjustments in service packages as a result of these recommendations, makes recommendations for long-term system reform, and provides a fiscal implications of reform options.

DISCUSSION

The federal Omnibus Budget Reconciliation Act of 1981 authorized states to provide Medicaid long-term care services in home and community-based settings instead of institutions such as skilled nursing facilities, intermediate care facilities, and intermediate care facilities for persons with mental retardation (later renamed intermediate care facilities for individuals with intellectual disabilities – ICF/IID). Named after Section 1915(c) of the Social Security Act, these programs are known as Medicaid 1915(c) waiver programs because they "waive" off certain requirements in the act. Since 1981, the number of individuals served in community waiver programs has expanded significantly for a variety of reasons. These reasons include: a strong preference among individuals to be served in their communities; legal precedent to serve individuals "in the most integrated setting appropriate to the needs of the person" due to passage of the federal Americans with Disabilities Act (1990) and the *Olmstead v. L.C. and E.W.* Supreme Court decision (1999); and the expectation that community programs are cost effective relative to institutional care. Nationwide, by 2010, nearly 1 million people were being served in 315 1915(c) waivers.

According to the Department of Aging and Disability Services (DADS), in 2010, there were an estimated 453,000 people with intellectual and developmental disabilities (IDD) in Texas. Of this total, the "priority population" is estimated to be 126,000. The priority population is based on DADS' formal estimate of the number of people who would qualify for services based on severity of intellectual disability and adaptive behavior deficits. Texas offers consumers a continuum of services including General Revenue-funded safety net services, community waiver programs, and ICF/IID institutional services (including 13 state-supported living centers and privately operated ICFs/IID). Because Texas offers both institutional and community-based services and continues to fully fund both systems, the system is known as a "dual-funded" system.

TEXAS' 1915(C) MEDICAID WAIVER PROGRAMS FOR INDIVIDUALS WITH IDD

Texas has six 1915(c) waiver programs for persons who are aging and have physical disabilities, and individuals with intellectual and developmental disabilities (IDD). Of these programs, two waivers serve persons who are aging or have physical disabilities and "waive off" of the nursing facility entitlement benefit (Community Based Alternatives "CBA" and Medically Dependent Children Program "MDCP"). Four waivers serve persons with IDD and "waive off" of the ICF/IID entitlement benefit (Home and Community-based Services "HCS," Community Living Assistance and Support Services "CLASS," Deaf Blind Multiple Disabilities "DBMD," and Texas Home Living "TxHmL"). **Figure 1** shows comparative information on the IDD waiver programs.

EVOLUTION OF TEXAS' IDD WAIVERS

HCS, CLASS, and DBMD were established at different times to serve specific populations. Texas' HCS program was developed first, in 1985. Separate programs were developed to serve individuals with related conditions and deaf and blind clients with an additional disability instead of expanding HCS. In 2004, the state developed the TxHmL waiver as a "supports waiver" to provide a limited package of services to a targeted group of financially needy individuals. The waiver was a cost effective way for the state to serve clients in a Medicaid program with matching Federal Funds who had previously received services only with programs funded through General Revenue Funds. The maximum annual cost in TxHmL is $17,000 compared to the cost limits of $167,468 to $305,877 in HCS, making TxHmL a more cost effective option than expansion of HCS.

While DADS operates all four waivers, the waivers were initiated by different legacy health and human services agencies prior to their consolidation following the Seventy-eighth Legislative Session, 2003. Because these agencies

FIGURE 1
KEY FEATURES OF TEXAS IDD WAIVERS, 2012

	HOME AND COMMUNITY-BASED SERVICES (HCS)	COMMUNITY LIVING ASSISTANCE AND SUPPORT SERVICES (CLASS)	DEAF BLIND MULTIPLE DISABILITIES (DBMD)	TEXAS HOME LIVING (TxHmL)
Year Initiated	1985	1991	1995	2004
Initiating Agency	Texas Department of Mental Health and Mental Retardation	Department of Human Services	Texas Rehabilitation Commission	Texas Department of Mental Health and Mental Retardation
Functional Eligibility	Individuals of any age with deficit in adaptive behavior and ID (IQ below 70) or a related condition with an IQ of 75 or below.	Individuals of any age who have a related condition that originated before age 22 and affects person's ability to function in daily life.	Individuals of any age with deaf blindness and one or more other disabilities that impair independent functioning.	Individuals of any age with deficit in adaptive behavior and ID (IQ below 70) or a related condition with an IQ of 75 or below.
Financial Eligibility	Up to 300% of Supplemental Security Income (SSI) monthly income limit. Parental income not considered.	Up to 300% of SSI monthly income limit. Parental income not considered.	Up to 300% of SSI monthly income limit. Parental income not considered.	SSI income limit. Parental income considered.
Service setting (residential options)	Individual home, 3 to 4 bed group home, or foster home	Individual home	Individual home, group home, small assisted living facility	Individual home
Common services	• Direct care services (supported home living) • Nursing • Professional therapies • Dental • Adaptive aids • Minor home modifications	• Direct care services (habilitation) • Nursing • Professional therapies • Dental • Adaptive aids • Minor home modifications • Transition assistance services	• Direct care services (habilitation) • Nursing • Professional therapies • Dental • Adaptive aids • Minor home modifications • Transition assistance services	• Direct care services (community support) • Nursing • Professional therapies • Dental • Adaptive aids • Minor home modifications
Unique services	Residential services (3 to 4 bed group home, foster care)	Specialized therapies	Intervener services, assisted living	No unique services
Functional Assessment Tool	Inventory for Client and Agency Planning (ICAP)	Provider Choice, Related Conditions Eligibility Screening Instrument	Provider Choice, Related Conditions Eligibility Screening Instrument	Inventory for Client and Agency Planning (ICAP)
Fiscal Year 2011 Clients	Total: 19,384 Residential: 6,499 Non-Residential: 12,866	4,642	152	912
Fiscal Year 2011 Average Monthly Cost	Total: $3,460.46 Residential: $5,104.26 Non-Residential: $2,631.49	$3,476.71	$4,112.76	$680.52
Fiscal Year 2011 Expenditures	$804.9 million	$193.7 million	$7.5 million	$7.5 million

FIGURE 1 (CONTINUED)
KEY FEATURES OF TEXAS IDD WAIVERS, 2012

	HOME AND COMMUNITY-BASED SERVICES (HCS)	COMMUNITY LIVING ASSISTANCE AND SUPPORT SERVICES (CLASS)	DEAF BLIND MULTIPLE DISABILITIES (DBMD)	TEXAS HOME LIVING (TxHmL)
Maximum Annual Cost	Varies by consumer's level-of-need (LON): LON 1, 5, 8: $167,468 LON 6: $168,615 LON 9: $305,877	$114,736.08	$114,736.08	$17,000.00
Number on interest list, as of August 2012	60,196	43,607	527	16,201
Longest wait on interest list, as of August 2012	9 or more years	8 to 9 years	3 to 4 years	N/A

Notes: HCS and CLASS client totals include clients served under the Promoting Independence Initiative.
The TxHmL program added 5,000 slots in the 2012–13 biennium which is not entirely captured in the fiscal year 2011 client data.
There is no interest list in the TxHmL program. DADS estimates that 16,201 persons on the HCS interest list would be interested in and eligible for TxHmL services.
Source: Legislative Budget Board.

approached implementation differently, there were a variety of programmatic differences across the waivers. Some of these differences are shown in Figure 1. There tend to be similarities in approach in HCS/TxHmL (former Texas Department of Mental Health and Mental Retardation programs) and CLASS/DBMD (former Department of Human Services/Texas Rehabilitation Commission programs).

After the consolidation of the health and human services agencies, the Texas Legislature directed the Health and Human Services Commission (HHSC) and DADS to address some of the differences across waivers and streamline waiver operations. This action was out of the concern that differences could be inefficient to the state, burdensome to providers, and unfair for clients. HHSC also standardized rates for many of the common services across programs. DADS established a Waiver Standardization and Streamlining Initiative in September 2009, which remains ongoing. The initiative has looked at reducing forms, revising program provider manuals, improving information systems functionality, and reviewing differences in services such as minor home modifications and adaptive aids. In addition to these activities, DADS also has an initiative to reduce provider burden across waivers. DADS solicited input from stakeholders and is conducting additional research to vet the suggestions and determine which to implement.

Despite this progress, administration of the four waivers remains complex and costly. Some examples of the complexities in the operation of multiple waivers include maintaining separate program rules and provider contracts/oversight. **Figure 2** shows the administrative costs for the IDD waivers in fiscal year 2012.

GROWTH IN IDD WAIVER PROGRAMS

In Texas, unlike the ICF/IID program, waiver programs are not entitlement programs. The Texas Legislature makes an appropriation each biennium that determines how many individuals will be served. The Legislature increased All

FIGURE 2
GENERAL REVENUE ADMINISTRATIVE COSTS FOR THE IDD WAIVERS, FISCAL YEAR 2012

	HCS	CLASS	DBMD	TXHML	TOTAL
Access and Intake Costs	$928,920	$457,339	$87,011	$379,136	$1,852,406
Regulatory Costs	2,401,624	N/A	N/A	581,568	2,983,192
General Administration	77,767	73,668	31,891	43,208	226,535
Total	**$3,408,311**	**$531,007**	**$118,902**	**$1,003,912**	**$5,062,133**

Note: DADS could not isolate regulatory costs for CLASS and DBMD because staff working in this area do not track workload activities by the type of provider (they are all Home and Community Support Services Agencies providers).
Source: Department of Aging and Disability Services.

Funds appropriations to waiver programs for the past several biennia, increasing the number of persons who can access services. **Figure 3** shows the growth in appropriations for IDD waiver program since fiscal year 2008. In the 2010–11 biennium, 5,936 new slots were funded in HCS, 1,890 in CLASS, and 6 in DBMD, among other programs. **Figure 4** shows the increase in clients served by program from fiscal years 2006 to 2011.

FIGURE 3
APPROPRIATIONS GROWTH FOR IDD WAIVER PROGRAMS, ALL FUNDS, 2008–09 TO 2012–13 BIENNIA (IN MILLIONS)

WAIVER	2008–09	2010–11	2012–13
HCS	$1,012.0	$1,357.6	$1,605.2
CLASS	$255.5	$422.2	$354.2
DBMD	$12.9	$14.8	$14.6
TxHmL	$13.3	$21.9	$89.7

Source: Legislative Budget Board.

While enrollment and spending in all the waivers increased HCS has grown significantly over time. Since the waiver's inception in 1985, HCS has grown to a program with 19,384 clients in fiscal year 2011. In addition to growth in enrolled persons, average monthly and total program costs have also increased. According to DADS, the program began with a daily rate of $45.90 (approximately $1,396.13 per month); today's average monthly costs in fiscal year 2011 were $3,460.46 (overall), $5,104.26 for a residential slot and $2,631.49 for a non-residential slot.

The HCS waiver has become the primary community-based program for persons with IDD. The program has the longest interest list and wait period due to the comprehensive nature of benefits provided. The program has also facilitated much of the state's deinstitutionalization. According to advocates and professionals in the field, the reason is that HCS services can evolve with a person over a lifetime. If someone begins the program as a child living at home, there are service options under HCS for that person to move into a group home, live in other foster/companion care arrangements, and move into his or her own home. Program expansion over time is reflective of these trends. As demonstrated previously in **Figure 3**, while there has been growth in CLASS, it has not occurred to the extent that it has in HCS. DBMD has remained a small program relative to the other IDD waivers. TxHmL had been a limited program until the fiscal years 2012 and 2013. The Legislature reduced funding for safety net services (General Revenue Funds) administered by local authorities (formerly known as mental retardation authorities) and funded 5,000 new TxHmL slots, with the intent of moving consumers who had been served by local authorities into TxHmL.

CHALLENGES CONFRONTING IDD WAIVER SERVICE SYSTEM

Challenges confronting the Texas IDD waiver system include identifying resources to meet demand and ensuring persons receive precisely the services they need. The state's ability to address these challenges is constrained by limitations in the functional assessment processes and tools used across waivers.

UNMET NEED FOR SERVICES

Significant unmet need exists among Texas' IDD population and is likely to remain for the near future. Because interest in the waiver programs exceeds the amount of services made available by appropriations, DADS uses interest lists to track interest in the programs and allocate services when they are available. The interest lists operate on a first-come, first-served basis; no functional or financial eligibility determination occurs prior to list placement. The size of the interest list varies by program, as does the wait period. **Figure 5** shows the total number of individuals on each interest list as of August 2012, by wait period and as a percentage of the total persons on the list. As of August 2012, the total number of persons across the three IDD lists was 104,330 (not

FIGURE 4
AVERAGE MONTHLY IDD WAIVER ENROLLMENT, FISCAL YEARS 2006 TO 2011

WAIVER	2006	2007	2008	2009	2010	2011
HCS	10,149	11,795	13,386	15,104	17,172	19,384
CLASS	2,111	3,094	3,833	3,949	4,221	4,642
DBMD	132	139	147	153	153	152
TxHmL	1,417	1,404	1,243	1,051	914	912

Notes: HCS and CLASS totals include Promoting Independence slots.
The TxHmL program added 5,000 slots in the 2012–13 biennium which is not entirely captured in the fiscal year 2011 client data.
Source: Legislative Budget Board.

FIGURE 5
NUMBER OF PERSONS AND PERCENTAGE OF TOTAL ON THE INTEREST LIST BY WAIT PERIOD, AUGUST 2012

WAIT PERIOD	CLASS	DBMD	HCS
0 to 1 year	13.1%	27.3%	14.2%
	5,695	144	8,522
1 to 2 years	16.2%	22.2%	15.2%
	7,073	117	8,955
2 to 3 years	16.1%	46.3%	15.2%
	7,037	244	9,136
3 to 4 years	14.4%	4.2%	13.1%
	6,287	22	7,889
4 to 5 years	13.0%	0.0%	10.6%
	5,645	0	6,374
5 to 6 years	10.9%	0.0%	8.8%
	4,762	0	5,287
6 to 7 years	7.0%	0.0%	7.0%
	3,041	0	4,172
7 to 8 years	5.6%	0.0%	5.6%
	2,444	0	3,327
8 to 9 years	3.7%	0.0%	5.5%
	1,623	0	3,317
9 or more years	0.0%	0.0%	5.1%
	0	0	3,090

Note: The DBMD totals include persons who have declined services multiple times but who have elected to remain on the list.
Source: Department of Aging and Disability Services.

FIGURE 6
INCREASE IN WAIT TIME FOR HCS AND CLASS, AUGUST 2010 TO AUGUST 2012

	AUGUST 2010	AUGUST 2012
HCS 8 to 9 years	992	3,317
HCS 9 or more years	0	3,090
CLASS 7 to 8 years	213	2,444
CLASS 8 to 9 years	0	1,623

Source: Department of Aging and Disability Services.

FIGURE 7
PERSONS RECEIVING DADS SERVICES WHILE ON IDD INTEREST LISTS, MARCH 31, 2012

	HCS	CLASS	DBMD
Count on Interest List	56,966	41,434	480
Number Receiving Other Services	14,318	9,610	187
Percentage Receiving Other Services	25.1%	23.2%	39.0%
Count in STAR+PLUS	1,035	874	18

Notes: This analysis does not include persons who receive services from entities other than DADS/HHSC such as through school districts.
Totals are unduplicated.
Source: Department of Aging and Disability Services.

unduplicated). TxHmL will not have its own interest list until August 2013; currently the HCS list is used to offer persons TxHmL slots as they become available. DADS estimates 16,201 persons on the HCS list could be interested and eligible for TxHmL services. It is assumed not everyone on the HCS list would qualify for TxHmL given that more restrictive financial eligibility requirements exist for TxHmL than HCS, as shown in **Figure 1**.

For some waivers, the wait period is increasing. When comparing DADS data from August 2010 to August 2012, the longest amount of time a person waited for an HCS slot increased from 8 to 9 years to 9 or more years and the longest amount of time a person waited for a CLASS slot increased from 7 to 8 years to 8 to 9 years, as shown in **Figure 6**.

Many persons receive some services while they wait for a waiver slot and some persons on the interest lists are later found ineligible or decline services when they are offered. **Figure 7** shows information on persons receiving services while they remain on interest lists. While some persons only receive services that meet some of their needs, for others, the services received are substantial. For example, of persons on the HCS interest list as of March 31, 2012 who are receiving other DADS/HHSC services, 17.0 percent were receiving ICF/IID services, 10.7 percent were receiving MDCP services, and 9.7 percent were receiving CLASS services. It is also likely that the entire population receiving services in TxHmL would desire HCS services and that many are on the interest list. Because no functional or financial eligibility determination exists prior to list placement, some persons are found ineligible for services when they are offered, as shown in **Figure 8**.

Even when adjusting for persons receiving other services and for persons who would be found ineligible/decline services if offered, there is still substantial unmet need. The need is likely to remain in the near future, and the number of individuals on the interest lists remains the best proxy for measuring unmet need. According to DADS, if Texas wanted to eliminate the unmet need and effectively treat the waivers

FIGURE 8
PERSONS ON INTEREST LISTS WHO WERE DENIED OR DECLINED SERVICES WHEN OFFERED
AUGUST 2011 AND AUGUST 2012

WAIVER	AUGUST 2011	AUGUST 2012
HCS	1,710	0
CLASS	1,837	39
DBMD	0	23

NOTE: The difference in years can be explained by the fact that there were more slots available in the fiscal years 2010 and 2011 than in fiscal years 2012 and 2013.
SOURCE: Department of Aging and Disability Services.

as entitlements, the additional cost in fiscal years 2014 and 2015 could be as much as $946.2 million in General Revenue Funds ($2.3 billion in All Funds) (based on February 2012 interest list). While other states have funded expansion of community services for persons with IDD by rebalancing their long-term care systems and reducing provision of care in private and state-operated institutions, Texas continued operation of a dual-funded system of IDD services. The dual-funded system necessitates the identification of other revenue sources or cost savings within the program whenever expansion of community services occurs.

LIMITATIONS OF THE IDD SERVICE CONTINUUM

The Texas continuum of services for persons with IDD is shown in **Figure 9**. Moving from left to right on the continuum, the cost of programs, richness of benefits, and wait time to access services increases. For illustrative purposes, only data on HCS are included in the third column in the figure given the program's size (in terms of the number of enrolled clients), consumer preference for the package of services it offers (give the size of the interest list), and its relationship to TxHmL and ICFs/IID.

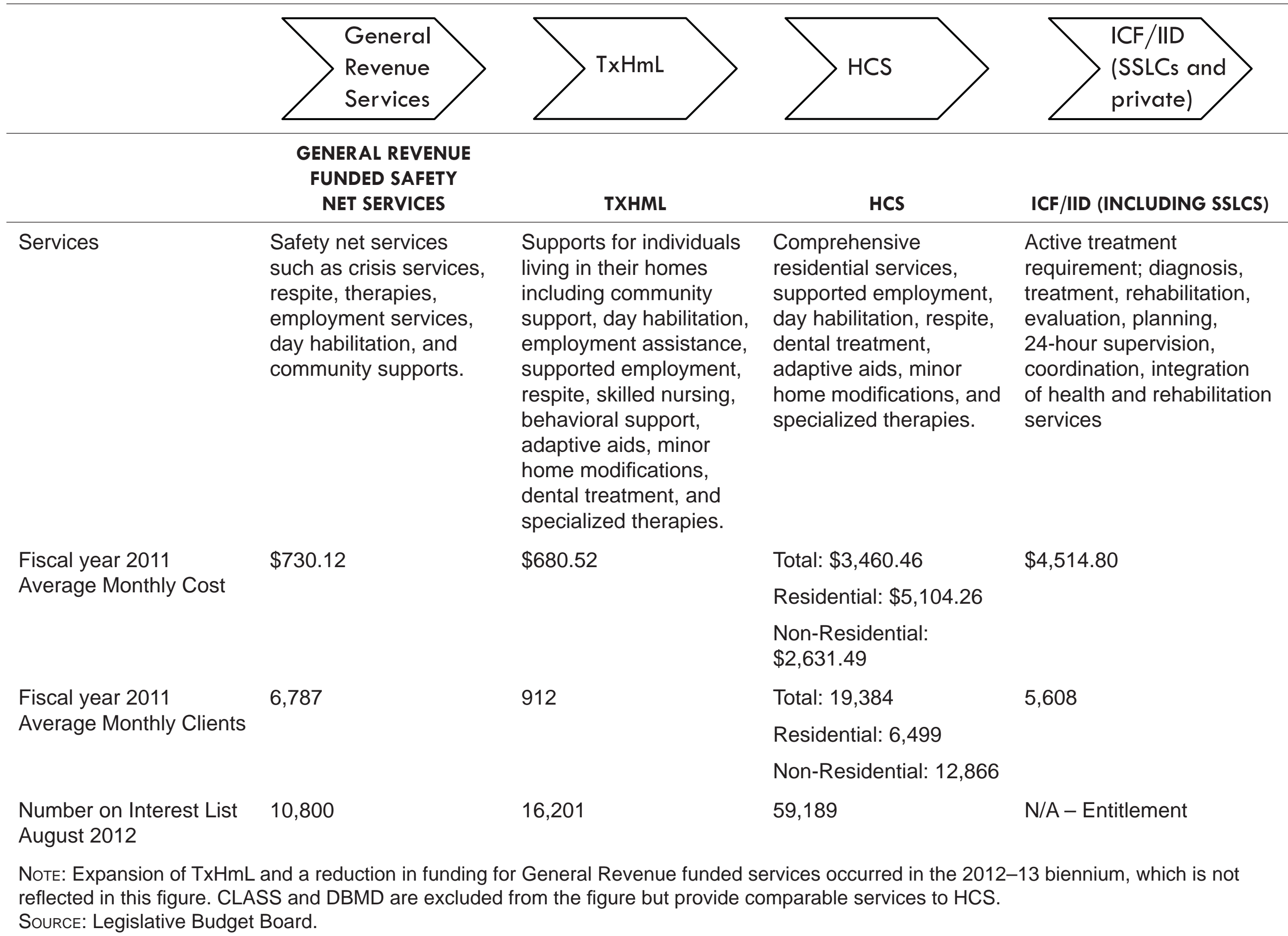
The strength of this system is that its structure provides budget certainty to the state. Each of these programs has a defined set of services available and a maximum cost limit. The state sets appropriations for General Revenue-funded services and the waiver programs and this determines the number of persons to be served. If the state were to attempt to serve all clients in HCS, the cost would be much greater than the cost of the current system. It is possible that when individuals can access a greater number of services and supports, they are more likely to use them.

A main weakness of the system is that its structure does not ensure that clients receive the services they need. The system's design results in some misalignment of clients and programs, which can result in both over and under provision of services. Waiver clients are not necessarily receiving services in the program best suited to meet their needs. Since the interest lists operate on a first-come, first-served basis and the wait for more comprehensive services is longer than the wait for less comprehensive services, persons may be stratified across the system based on how long they have been waiting and not due to needs. There are individuals receiving General Revenue-funded safety net services administered by local authorities and TxHmL who have more extensive needs and are waiting to be served in HCS. There are also individuals in HCS may have been receiving adequate services in another program such as TxHmL, but opted to accept the HCS slot when it was offered out of fear that they might not be able to access services in the future. There is no mechanism under the current system to allow someone to move across programs as their needs or available supports change. This encourages individuals to enroll in more comprehensive programs than might be needed at present because they expect to have higher needs in the future.

Identifying the extent to which over-provision of services is occurring in Texas IDD waivers is difficult to quantify. However, research from other states and an analysis of factors that may have contributed to over-provision of services supports the idea that some savings could be gained in this area. Research performed by Human Services Research Institute has shown that in several states and some Canadian provinces, there is not necessarily a correlation between needs and supports, resulting in varying levels of funding for persons with similar needs. Other research has found unnecessary variability in spending on clients with similar needs, suggesting that "patterns of spending for the developmentally disabled…are not based on need, but instead reflect location, agency bias, or even funding by county." This variability results in higher program costs than may be necessary. For example, in its effort to align spending with consumer needs, the Louisiana Office for Citizens with Developmental Disabilities identified approximately 2,600 persons who were receiving more waiver services than were necessary. After implementing a new assessment tool and resource allocation process, the state was able to identify an average annual savings per service plan of $17,917.

DADS has not been directed to conduct analysis of the costs of service plans by level-of-need so the extent to which variability exists across plans is unknown. However, several factors are likely to have contributed to over-provision of services over time. Although there are efforts to control costs,

FIGURE 9
IDD SERVICE CONTINUUM, 2012



	GENERAL REVENUE FUNDED SAFETY NET SERVICES	TXHML	HCS	ICF/IID (INCLUDING SSLCS)
Services	Safety net services such as crisis services, respite, therapies, employment services, day habilitation, and community supports.	Supports for individuals living in their homes including community support, day habilitation, employment assistance, supported employment, respite, skilled nursing, behavioral support, adaptive aids, minor home modifications, dental treatment, and specialized therapies.	Comprehensive residential services, supported employment, day habilitation, respite, dental treatment, adaptive aids, minor home modifications, and specialized therapies.	Active treatment requirement; diagnosis, treatment, rehabilitation, evaluation, planning, 24-hour supervision, coordination, integration of health and rehabilitation services
Fiscal year 2011 Average Monthly Cost	$730.12	$680.52	Total: $3,460.46 Residential: $5,104.26 Non-Residential: $2,631.49	$4,514.80
Fiscal year 2011 Average Monthly Clients	6,787	912	Total: 19,384 Residential: 6,499 Non-Residential: 12,866	5,608
Number on Interest List August 2012	10,800	16,201	59,189	N/A – Entitlement

Note: Expansion of TxHmL and a reduction in funding for General Revenue funded services occurred in the 2012–13 biennium, which is not reflected in this figure. CLASS and DBMD are excluded from the figure but provide comparable services to HCS.
Source: Legislative Budget Board.

it may be difficult to eliminate some of the growth in program costs.

First, the program has historically allowed individuals to choose whether they receive residential services, and if so, which type. This is a major cost driver in the program. As shown in **Figure 10**, the average monthly cost of a residential slot is approximately $2,472.77 greater than a non-residential slot. Among the residential service options, it is more expensive to serve persons in group homes than in foster/companion care. Most individuals entering the HCS program either by coming from the interest list or coming out of institutions via the Promoting Independence Initiative opt to be placed in either a group home or foster care setting (combined since both are residential options), as opposed to their homes. **Figure 11** shows this trend over the past four years. Provision of residential services has not been linked to need (in terms of IQ, ability to perform activities of daily living, or availability of caretaker(s)) or cost. There may be instances when serving someone in their home is more expensive than a group home, while in other instances the group home is the more expensive option. Regardless of cost, the personal preferences of the consumer are honored.

Another possible contributing factor to the over-provision of services is that HCS providers performed case management from 2003 and 2010. In performing this function, HCS providers were responsible for the service planning process for clients including determining when to review the client's level-of-need (a variable that determines the rate of reimbursement for some services and ties to the overall cost limit for the client). Some have argued that providers had a financial incentive to increase the number of hours and services clients received. In fiscal year 2010, responsibility for service coordination was transferred to local authorities per the 2010–11 General Appropriations Act, Article II, Section 48, in order to separate the service coordination function from direct service provision. It is not possible to determine

FIGURE 10
AVERAGE MONTHLY COSTS OF SERVING CONSUMERS BASED ON HCS RESIDENTIAL SETTING, FISCAL YEARS 2008 TO 2011

ORIGIN	SETTING	2008	2009	2010	2011
Interest List	Residential	$4,496.10	$4,500.50	$4,926.70	$4,949.40
	Foster Care	$2,998.60	$3,025.50	$2,795.60	$2,768.30
	Own Home	$2,150.00	$2,234.50	$1,747.00	$2,101.50
State Supported Living Center	Residential	$4,715.40	$4,768.10	$5,301.60	$5,183.30
	Foster Care	$3,561.70	$3,180.10	$3,501.70	$3,869.30
	Own Home	$1,942.70	$2,746.70	$1,392.40	$40.00
Private ICF/IID	Residential	$4,822.10	$4,870.10	$5,243.00	$5,011.30
	Foster Care	$3,271.90	$3,361.30	$2,864.20	$3,012.80
	Own Home	--	--	--	$1,300.90

Source: Department of Aging and Disability Services.

FIGURE 11
RESIDENTIAL PLACEMENT BY POINT OF ORIGIN, FISCAL YEARS 2008 TO 2011

POINT OF ORIGIN	SETTING	2008	2009	2010	2011
From ICF/IID (public or private)	Own home	3	9	3	6
	Residential placement	176	342	236	367
From Interest List	Own home	450	764	685	1,163
	Residential placement	789	1,689	1,488	2,627

Source: Department of Aging and Disability Services.

whether the change improved cost control in the HCS program because data are not yet available for analysis. It is reasonable to expect that moving the provision of service coordination to a third-party could reduce or contain growth in utilization if it is true that HCS providers used the service planning process to increase their reimbursement. As more data becomes available, it may be possible to determine whether the transition of service coordination affected service utilization and whether any correction for cost growth in the program can occur.

In addition to not having controls on the front end of the planning process to contain costs, how the Texas Department of Mental Health and Mental Retardation and DADS performed utilization review may have also inhibited the ability to detect unnecessary provision of services. Utilization review is a mechanism used to review the appropriateness of service provision, given client needs. While DADS is enhancing utilization review activities and trying to make these activities uniform across waivers, some historical practices may have inhibited the agency's ability to detect inappropriate service requests. Utilization review practices did not routinely include face-to-face client reviews. Reliance on desk review was problematic because staff only had materials to review that were supplied by the providers. Also, although the agency did monitor for gradual increasing of plan costs, some of the strategies used may have only worked to detect egregious cases in which the client's service cost reached certain thresholds. There could have been cost growth occurring under the cap that may not have been detected. In total, utilization review activities employed may not have been effective in containing program costs. Going forward, because DADS has expanded utilization review activities to include sampled face-to-face reviews, among other activities, the agency might be better positioned to contain future program costs.

LIMITATIONS OF ASSESSMENT PROCESSES AND TOOLS IN TEXAS

Limitations of the functional assessment processes and tools used across IDD waiver programs have inhibited the state's ability to understand the needs of consumers, which makes it difficult to ensure persons receive the services they need. In addition, a lack of assessment of the needs of interest list consumers hinders long-term planning.

The functional assessment process determines the type and quantity of services clients receive and is the basis for the

person-centered planning process. A functional assessment tool is an instrument that can be used in a variety of ways including determining program eligibility, assessing deficits or strengths, and identifying needs and supports.

Some of the differences in the functional assessment tools used are shown in **Figure 12**. In HCS and TxHmL, the Inventory for Client and Agency Planning (ICAP) tool is used to assess needs and deficits. The ICAP is a standardized assessment tool used across the United States that measures skills in several areas: adaptive, maladaptive, motor, personal living, community living, social and communication, and broad independence. The ICAP score is translated to a level-of-need (LON), which is used to establish the cost limit for a client's service plan (see **Figure 1** for the cost limits by LON).

In CLASS and DBMD, two assessments determine functional eligibility. Providers may choose from several tools including Vineland, ICAP, Scales of Independent Behavior – Revised (SIB-R), or the American Association of Intellectual and Developmental Disabilities Adaptive Behavior Scales (AAIDD ABS). In addition, the Related Conditions Eligibility Screening Instrument is used to assess adaptive behavior level. Given use of differing tools across programs, an Intellectual Disability/Related Condition assessment form must be filled out for clients across IDD programs. Since 2009, this form has been used across all the waivers in an attempt to capture some consistent information for all persons.

Use of different tools makes it difficult to compare needs across programs. In addition, the tools are only capturing information pertinent to the programs within which they are used. For example, because residential services are not offered in CLASS, the assessment process does not need to capture information about whether CLASS consumers need or would prefer to receive residential services.

In addition to the use of different tools across IDD waivers, the existing processes and tools may not provide the state with complete information about individuals' needs. Various stakeholders have criticized the ICAP for several limitations including its deficits-focus (instead of a strengths-based approach). This means the tool identifies the consumer's deficits, not the supports a person needs. This approach differs from other nationally used tools. Also, according to DADS staff, the ICAP was never intended to be used to determine reimbursement rates for services. Texas has had to develop a methodology to convert the ICAP score to a LON, which is used for reimbursement purposes and to set the cost limit for the service plan. Some other tools used nationally are constructed differently and are used in tandem with resource allocation strategies which seek to introduce less variability into this process. Finally, the ICAP and the assessment tools used in CLASS/DBMD have been criticized for their lack of comprehensiveness in capturing all necessary health and behavioral information about an individual.

FIGURE 12
FUNCTIONAL ELIGIBILITY ASSESSMENT AND SERVICE PLANNING, 2012

FUNCTION	HCS	CLASS	DBMD	TXHML
Case Management (Service Coordination) Provider	Local authority (LA)	Contracted case management agency	Provider agency	Local authority
Entity that Performs Functional Eligibility Determination	LA completes assessment, DADS authorizes	Home health agency completes assessment. DADS authorizes	Provider agency (home health agency or assisted living facility) completes assessment, DADS authorizes	LA completes assessment, DADS authorizes
Assessment Tool Used	ICAP	Provider choice across multiple options Related Conditions Eligibility Screening Instrument	Provider choice across multiple options Related Conditions Eligibility Screening Instrument	ICAP
Direct Service Provider	Provider agency (some LAs are also provider agencies)	Home health agency	Provider agency	Provider agency (some LAs are also provider agencies)
Entity that Conducts Utilization Review	DADS	DADS	DADS	DADS

Source: Department of Aging and Disability Services.

An additional concern with the existing assessment practices is that consumers on the interest list are not assessed prior to list placement. Some information may be known about the needs of some persons who receive services while they wait, but the assessments used by those programs may only capture information relevant to that program and may not be a complete reflection of needs.

IDD WAIVER REFORM OPTIONS

Like Texas, many states have large client demand for services and are experiencing budget pressure in their IDD programs. Recent surveys by the Center for Health Care Strategies and AARP found many states are on the cusp of transformation of the financing and delivery of long-term care services and supports. The AARP survey found 15 states are considering consolidation of their waiver programs to gain additional efficiencies and reduce administrative costs, given that the federal government now permits states to consolidate waivers that have served separate populations (i.e., aged/disabled and IDD waivers). Other states are testing innovations in delivery systems of care for persons with IDD. According to the Center for Health Care Strategies, Rhode Island and New York have been active in the area of health homes and affordable care organizations, respectively. According to AARP, 11 states are planning to implement managed long-term care arrangements in 2012 on 2013. As many as 18 states are considering implementation of a new program authorized under the federal Affordable Care Act (ACA) that could potentially reduce demand for more expensive waiver services. The ACA allows states to receive a 6 percent enhanced federal match to create a new attendant care/habilitation benefit under the Community First Choice Program. This program would provide supports to persons residing in their homes in the community. It would provide access to services to persons on interest or waiting lists for waiver services while they wait and could reduce the demand for waiver services if attendant care/habilitation meets most of the needs of persons and they do not need or want the other services included in the waiver (i.e., therapies, nursing).

In Texas, there have been ongoing discussions at the state-level about various reform options. The Eighty-second Legislature, First Called Session, 2011, passed Senate Bill 7, requiring HHSC to seek an 1115 demonstration waiver to redesign the state's Medicaid program. The legislation included a provision that the waiver "allow for the redesign of long-term care services and supports to increase access to patient-centered care in the most cost-effective manner." The legislation did not prescribe what the redesign should involve; DADS began soliciting public input on the redesign in fall 2012. However, due to a lack of information about the needs of persons on the interest lists and about the needs of consumers in the IDD waivers as a result of limitations in the functional assessment processes, long-term planning and evaluation of these reform options is limited. Implementation without this information could expose the state to financial risk.

Consolidation of some or all of Texas IDD waivers could eliminate remaining programmatic differences across waivers, provide consumers with access to needed services, and result in administrative savings or efficiencies. However, consolidation, absent any other changes in program design (such as providing residential services based on preference and not need) could also result in significant increased costs due to creation of a merged service array. There could be an increase in the take-up of these services from persons now being served in programs without them (i.e., CLASS, TxHmL). However, the degree to which this would occur is unknown because standard information about needs/preferences is not captured across programs. Because federal law requires that all persons served in a waiver be offered comparable services and have the ability to access all needed services, the state would have limited options to prevent this increase in utilization. For example, the state could not exclude persons from the former CLASS or TxHmL waivers from accessing residential services in a newly merged waiver that offered residential services unless the criteria applied to everyone in the waivers equally.

Managed care could offer Texas flexibility, better integration of care, and improved resource decisions, according to a 2010 Health Management Associates report that evaluated different managed care pilot program options for Texas. However, the report concluded that there was "not enough evidence that capitation would create savings sufficient to justify the risks and effort involved with significantly restructuring the IDD service delivery system." The lack of standard information about current client and interest list client needs could complicate the implementation of managed care if Texas moved forward with this option. Setting of initial rates and ongoing validation of the appropriateness of rates overtime could be difficult without a thorough understanding of client needs. In addition, if populations served under multiple waivers were brought into managed care and offered the same service array, this option could be more costly than the current system.

Implementation of a Community First Choice program in Texas (attendant care/habilitation benefit added to state

plan) would create an entitlement program that DADS estimated in its fiscal year 2014–15 Legislative Appropriations Request would serve 11,902 persons at a cost of $35.8 million in General Revenue Funds for fiscal year 2015. It is unknown what impact, if any, the program will have on the number of persons who would remain on the HCS interest list given the lack of information about the needs of the interest list population. Given that many persons who receive the benefit are likely to remain on the interest list for HCS to gain access to residential services and other waiver services, creating this benefit may not significantly change demand for HCS services but would result in a long-term funding commitment through creation of a new entitlement program.

These reform options provide Texas with the opportunity to address some of the challenges confronting its continuum of services for persons with IDD. However, without information to vet the costs and benefits of these approaches, implementation may expose the state to differing degrees of financial risk.

USING A STANDARD ASSESSMENT TOOL TO ENABLE LONG-TERM REFORM OF IDD WAIVERS IN TEXAS

For states with limited resources, improving the functional assessment process can provide a means of better understanding consumer needs. Understanding needs can aid long-term system planning, and enable identification of cost savings through the development of resource allocation models. By ensuring persons receive only the services they need, a state may realize savings that can be used to serve additional consumers.

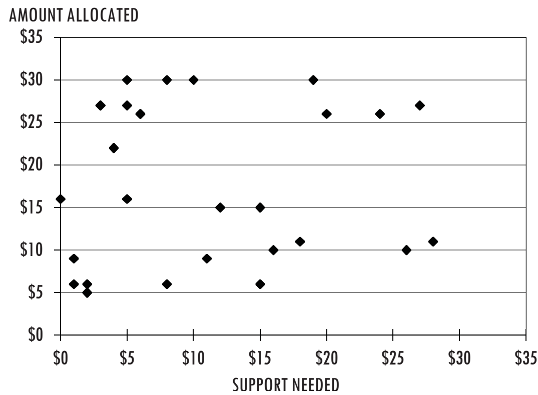
Many states have expressed dissatisfaction with their needs assessment process/tool. Some are looking to adopt national standardized assessment tools and others are developing state tools. One national tool that has received considerable attention is the Supports Intensity Scale (SIS). This tool is a strengths-based evaluation of a client's needs in 87 areas including 57 life activities, and 28 behavioral and medical areas. The test is administered by someone with a four-year college degree (which differs from ICAP which can be administered by any individual that knows a client). It measures needs in multiple areas: home living, community living lifelong learning, employment, health and safety, social activities, and protection and advocacy. It also has high inter-reliability and a recent academic evaluation found the tool "is an effective instrument for measuring differences in support needs and informing decision-making in regard to disbursing funding." The tool has also been tested for use with persons with intellectual and developmental disabilities, whereas the ICAP is only used for persons with an intellectual disability. States can also modify the assessment to collect additional, state-specific information. Although past versions of the SIS have only been able to be used for adults, a module for children is currently being field tested. According to the American Association on Intellectual and Developmental Disabilities (AAIDD), approximately 30 states, many of which formerly used the ICAP, now use the SIS.

One of the primary reasons many states have shifted to a new assessment tool, and particularly, the SIS, has been to improve resource allocation. The SIS clearly identifies support needs in areas such as home living activities, community living activities, and health and safety activities. The SIS also identifies medical and behavioral issues that the Human Services Research Institute (HSRI) has found to be significant cost predictors. Resource allocation strategies seek to improve the correlation between needs and program spending. **Figure 13** and **Figure 14** show how resource allocation strategies hope to shift spending from a scenario in which much variability exists by level-of-need to one in which there is a stronger relationship between needs and spending.

With improved assessment data, some states have contracted with an entity to develop a methodology to convert the assessment information (i.e., the SIS score) to a level of service. This can take several forms. Under level-based budgeting (also known as tiering) individuals are assigned to levels or tiers based on need and may only access services within their tier. If their needs or supports change, they can move to another between tiers based on their reassessment. Another approach is to use individual budgeting with a prospective budget (i.e., budget provided before the service plan is created). Many states have moved toward implementation of individual budgeting in conjunction with use of the SIS, as shown in **Figure 15**. According to HRSI, there are several benefits of individual budgeting including resource allocation that is more efficient and equitable, benefits to consumers from increased self-direction of services, and benefits to states for long-term planning such as provision of a more realistic estimate of the financial impact of serving persons on waiting/interest lists, among others.

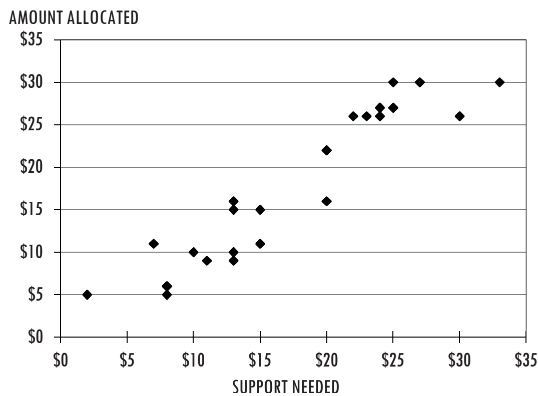
Recommendation 1 would amend the Texas Human Resources Code to require DADS to implement an automated functional assessment tool across state programs serving clients with intellectual and developmental

FIGURE 13
EXAMPLE OF WEAK CORRELATION BETWEEN FUNDING AND NEEDED SUPPORTS



SOURCE: Human Services Research Institute.

FIGURE 14
EXAMPLE OF STRONG CORRELATION BETWEEN FUNDING AND NEEDED SUPPORTS



SOURCE: Human Services Research Institute.

disabilities. There are two key components to this recommendation: (1) the tool selected should be used across all IDD programs; and (2) Texas should select a tool that is better able to link needs with resource use than any of the current tools in use by IDD programs.

DADS would have the discretion to select a national tool such as the Supports Intensity Scale (SIS) or to develop a state-based tool. In its 2010 report, Health Management Associates discussed the benefits to Texas from use of the SIS tool and indicated that in stakeholder discussions and discussions with agency staff, there was considerable support for it. According to the American Association on Intellectual and Developmental Disabilities (AAIDD), approximately 30 states, many of which formerly used the ICAP, now use the SIS.

FIGURE 15
OTHER STATE ACTIVITIES USING SIS AND FUNDING MODELS, 2012

ACTIVITY	STATES
States using SIS to set individual budgets	Colorado, Georgia, Louisiana, Oregon, Washington
States in process of using SIS to set individual budgets	Maine, New Mexico, North Carolina, North Dakota, New Hampshire, Rhode Island
States with SIS data collected/working toward implementation of individual budgets	Kentucky, Maryland, Missouri, New Hampshire, Pennsylvania, Rhode Island, Utah, Virginia
States using or considering using other assessment instruments for individual budgeting	Arkansas, Connecticut, Florida, Indiana, Mississippi, New Jersey, New York, South Dakota, Washington DC, Wyoming

SOURCE: Human Services Research Institute.

Recommendation 1 would authorize DADS to develop a state-based tool, if analysis suggested it would be more cost effective and beneficial for Texas. Some states have not found existing tools, including the SIS, to meet their needs. Vermont, Minnesota, and New Jersey have developed automated standardized assessment tools according to a recent Center for Health Care Studies survey. Many of these proprietary, state-based tools were developed after extensive stakeholder involvement and could serve as models for Texas. Texas could still move forward with resource allocation initiatives even if the SIS is not used, though staff from the HSRI maintain that some steps are likely to be necessary to shore up the validity of the current assessment system. Because the ICAP and other tools are not directly used to determine the level of resources available to consumers, the stakes are not as high with the administration of the ICAP. Under this option, DADS may wish to reassess everyone using existing tools and concentrate training or other resources to ensure integrity of results.

DADS should involve stakeholders in the process of selecting the new functional assessment tool. Failure to obtain stakeholder buy-in that the tool has valid and accurate results could result in opposition to future policy decisions made based on data obtained from the tool including resource allocation. For example, when Florida implemented tiered waivers, clients filed thousands of appeals immediately following implementation. The volume of appeals to process required considerable state resources and time, and the state

eventually transitioned from tiered waivers to individual budgets. Advocates stress the need to take time, consider input from interested parties, and protect client rights, regardless of the outcome selected. Advocates support the right to appeal the assignment of LON.

DADS should also consider how to validate the instrument. This was previously an issue when Texas tried to adopt a single assessment instrument in 2000. The Seventy-fourth Legislature directed the Health and Human Services Commission to develop a functional assessment instrument to predict utilization of services in all Medicaid long-term care programs. The instrument developed was called the Texas Instrument for Functional Assessment. An independent evaluation of the tool found different assessors frequently disagreed on client scoring using the tool and it did not predict resource use well. There have been many developments in available national tools since 2000, which suggest the state could have a different experience if it adopted a standard tool now. However, the lessons learned from this previous experience about the need to validate the instrument should inform implementation of a new tool.

Once the tool is selected, DADS would be required to prepare an implementation plan and submit it to the Legislative Budget Board and the Office of the Governor by August 31, 2014. The plan should include the tool DADS has identified for use across the state's IDD programs and a rationale for its selection, the plan and timelines for rollout of the tool across programs in the IDD continuum of services, and identify any issues or risks the agency has identified that will effect implementation.

DADS would be required to begin assessments of clients currently served in IDD waiver programs in fiscal year 2015. Given that resource allocation will be implemented in the HCS waiver, DADS should prioritize assessments of consumers in the HCS program. The agency would retain flexibility to determine the optimum approach to expand the tool's use across ICFs/IID, General Revenue-funded services, and the interest lists in subsequent years. Individuals could be assessed on a rolling basis depending on the timing of their annual service plan reviews. Recommendation 3 would include a contingency rider in the introduced 2014–15 General Appropriations Bill to fund implementation of the new tool.

Use of a more robust assessment tool across the IDD waivers offers Texas many benefits. According to DADS June 2012 Balancing Incentive Program (BIP) application, "the advantages of a single assessment instrument are compelling." DADS found "using one instrument to track an individual as he or she moves throughout the LTSS should result in greater efficiency and higher quality service." In the short-term, use of an improved tool across all IDD programs could result in collection of standardized data across programs and improve program management (e.g., improve budgeting and quality monitoring). It could also improve the person-centered planning process. According to the American Association on Intellectual and Developmental Disabilities, the entity that developed the SIS tool, people can overlook ways to enhance the quality of life for individuals with IDD, whereas the SIS tool can facilitate the development of plans that are "person-centered, complete, and creative."

Use of a standardized tool could also provide DADS with the information needed to implement a resource allocation initiative in the HCS waiver. Recommendation 2 would amend statute to direct DADS to implement this initiative in the HCS waiver. By ensuring persons receive only the services they need, savings from reduced program costs could be used to serve more individuals on the interest lists. This recommendation is a major philosophical shift from the current approach to service planning in Texas, in which consumer preferences have been a major cost driver. Under a resource allocation initiative, such as individual budgeting, information gained from the assessment tool could improve planning for the IDD system and aide in consideration of options such as consolidation of the waivers, managed care, and the addition of new benefits.

Based on the experience of other states, it is assumed implementation of both the new assessment tool and resource allocation initiative would occur across several years and into the fiscal years 2016 and 2017. Other states developed implementation plans that rollout tools across different populations over several years to minimize the costs incurred and provide time for engagement of stakeholders.

Implementation of Recommendations 1 and 2 will require consideration of several factors, based on HSRI experience in other states include:

- Identifying policy goals—Is the goal to ensure individuals receive what they need, increase consumer participation in service delivery, etc.? The goal(s) will influence program design features.
- Engaging stakeholders—Building in time for communication and engagement will affect the overall timing of the initiative's rollout.

- Compile reliable and accurate assessment information—Before resource allocation methodologies can be developed, data using actual assessments of individuals must be conducted. States may opt to collect some data and then use a methodology from another state that seems to fit their data or wait until robust data can be collected so a state-specific methodology can be created.
- Choose between tiered waivers or individual budgets—Both tie a consumer to a funding level based on need but a state's decision may hinge on what goals it hopes to accomplish with the initiative. For example, if the goal was to increase consumer engagement, individual budgeting might be a better option.
- Examine current payment rates and reconcile to information gained through the assessment process. A state may want to incentivize certain services over others or make rate changes once assessment information is available.
- Develop an implementation plan that does not disrupt service provision. A state will have to consider how use of a new tool and resource allocation methodology can be integrated into the existing service planning framework and phased-in so as to minimize the adverse implications to consumers.

Recommendation 3 would include a contingency rider in the 2014–15 General Appropriations Bill to provide DADS with an appropriation contingent upon enactment of legislation relating to Recommendation 1.

Recommendation 4 would include a contingency rider directing DADS, in collaboration with the Health and Human Services Commission, to issue a report to the Legislative Budget Board and the Governor by March 1, 2015 that analyzes the needs of consumers across IDD waiver programs based on information gathered through use of the standard assessment tool, quantifies the values of any adjustments in service packages as a result of these recommendations, makes recommendations for long-term system reform, and provides a fiscal implications of reform options.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendations 1 and 2 would amend statute to implement a new standard functional assessment tool and resource allocation methodology and are estimated to have a fiscal year 2014–15 biennial cost of $1.5 million in General Revenue funds, as shown in **Figure 16**. Recommendation 3 would provide DADS with an appropriation contingent upon enactment of legislation relating to Recommendations 1 and 2.

These recommendations include $1.0 million in All Funds ($0.5 million in General Revenue Funds) to implement an existing tool such as the SIS and $2.0 million in All Funds ($1.0 million in General Revenue Funds) to contract with an entity to develop the resource allocation methodology for HCS. The analysis assumes the complete per assessment cost would be $20. This cost includes access to the SIS online platform, training, customization of the SIS assessment to include state-specific questions. It is also assumed that initially only persons in the IDD waivers, those leaving ICFs/IID to transition to the community, and new persons adding onto the interest lists would be assessed, and that assessments would occur every three years unless there was a need for reevaluation due to a change in diagnosis or supports. Additional funding needs are included in **Figure 16** to account for the cost of using the assessment tool across the IDD continuum, which is assumed to be phased-in. Once the initial assessment process has been complete, it is assumed ongoing reassessment costs could be accomplished within

FIGURE 16
FIVE-YEAR FISCAL IMPACT OF CHANGE IN ASSESSMENT TOOL, FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE FUNDS	PROBABLE SAVINGS/(COST) IN FEDERAL FUNDS	PROBABLE ADDITION/(REDUCTION) OF FULL-TIME-EQUIVALENT POSITIONS
2014	($500,000)	($500,000)	0
2015	($1,000,000)	($1,000,000)	0
2016	($625,000)	($625,000)	0
2017	($250,000)	($250,000)	0
2018	$0	$0	0

Source: Legislative Budget Board.

existing resources since DADS expends resources related to the service planning process currently.

If the state opted to develop its own tool, it is assumed implementation would take longer than using an existing tool and that no assessments would be completed during the 2014–15 biennium. The estimated total cost across biennia could range from $1.4 to $4.8 million, based on other states that developed similar assessment tools according to an April 2012 report funded by the SCAN Foundation. Once built, it is anticipated there would be one-time training costs for state staff and persons who would administer the tool (i.e., local authorities, CLASS case management agencies, providers).

A new federal program could provide the funding source for Recommendations 1 and 2. The Balancing Incentive Program (BIP) is a component of the federal Affordable Care Act that seeks to incentivize transformation of state long-term care systems by shifting the balance from institutional to non-institutional long-term services and supports (LTSS) through structural reforms to their long-term care systems. A total of $3 billion is available for distribution to states from October 1, 2012 to September 30, 2015. To qualify for the program, states must:

- Make structural changes in long-term care systems including:
    - no wrong door/single point of entry system;
    - conflict-free case management services; and
    - core standardized assessment instruments.
- Spend more than 50 percent of LTSS funding on community services by the end of the program.

CMS approved Texas' BIP application, with an estimated funding award of $301.5 million over the program period. Texas must use the funds for programs that "increase offerings of or access to non-institutional long-term services and supports, be for the benefit of Medicaid recipients, and not be a prohibited use of Medicaid funding." Assessment instruments are one of the three core structural requirements of the program; use of funding for this purpose should qualify as an acceptable use of the General Revenue Funds made available by the enhanced federal funding. However, if the state opts to develop its own tool and development takes longer than September 30, 2015, the state may not be able to use BIP funding for this purpose.

Recommendation 4 would have no significant fiscal impact. It is assumed that DADS could prepare the report required by this recommendation using existing resources.

The introduced 2014–15 General Appropriations Bill includes a contingency rider to implement Recommendations 3 and 4.

LEVERAGE THE STATE INSPECTION PROCESS TO INCREASE PERSON-CENTERED CARE IN NURSING FACILITIES

In 1987, the U.S. Congress passed legislation to address longstanding concerns of the health and safety of nursing facility residents. The impetus for this legislation was an independent report that identified the shortcomings and gaps in nursing facilities and their regulation. The legislation revamped the quality assurance system for nursing facilities and established specific residents' rights to allow for more person-centered care, and to elevate quality of life concerns to the same level as quality of care.

Despite its passage 25 years ago, many nursing facilities across the country are not fully implementing the principles in the federal legislation. According to a national survey, nursing facility providers believe that federal regulations are barriers to implementing person-centered care practices. One state, Rhode Island, through an innovative pilot project, sought to use the regulatory process to dispel this misperception and educate their state survey inspection staff and nursing facility providers about person-centered care practices and how federal regulations support their implementation. Participating nursing facilities increased person-centered care practices that resulted in residents having more opportunities to make their own choices in daily activities. According to the Texas Department of Aging and Disability Services, similar misperceptions exist in Texas despite agency efforts to educate nursing facility providers. Authorizing a pilot project using the nursing facility inspection process could educate providers and correct misperceptions about federal and state regulations and improve the quality of life of nursing facility residents.

FACTS AND FINDINGS

- ♦ As of fiscal year 2011, there were 87,533 Texans residing in 1,211 nursing facilities.
- ♦ The federal Omnibus Budget Reconciliation Act of 1987 established uniform minimum standards of care for Medicare and Medicaid-certified nursing facilities that are more person-centered and guarantee various resident quality-of-life rights.
- ♦ In 2009, the Centers for Medicaid and Medicare Services issued interpretive guidelines for provisions in the Omnibus Budget Reconciliation Act of 1987 to clarify that nursing facilities should begin or continue to de-institutionalize their physical environments and to provide person-centered care that emphasizes individualization, relationships, and a psychosocial environment that is comfortable for each resident.
- ♦ A 2008 survey by The Commonwealth Fund found that among nursing facility providers, regulation was perceived to be the most significant barrier to implementing person-centered care practices.

CONCERNS

- ♦ According to the Texas Department of Aging and Disability Services, despite the enactment of the Omnibus Budget Reconciliation Act of 1987 and agency efforts to educate nursing facility providers to the contrary, most providers continue to perceive regulations as barriers to implementing best practices to improve residents' quality of life.
- ♦ The Department of Aging and Disability Services is missing an opportunity to use its regulatory process to enhance nursing home providers' knowledge about how federal and state regulations support the implementation of person-centered care practices.

RECOMMENDATION

- ♦ **Recommendation 1:** Include a rider in the 2014–15 introduced General Appropriations Bill to direct the Texas Department of Aging and Disability Services to implement and evaluate a person-centered care pilot project modeled on the Rhode Island Individualized Care Pilot. This project would use the regulatory inspection process to enhance nursing facility providers' knowledge and implementation of person-centered care practices and culture change models of care.

DISCUSSION

Nursing facility regulation evolved from primarily a state responsibility to a shared responsibility with the federal government. Since the creation of nursing facilities in the 1930s, federal legislation has been enacted to address concerns regarding the variability of states' regulation of nursing facilities' quality of care and health and safety

standards. The most significant legislation is the enactment of the Nursing Home Reform Act contained in the Omnibus Budget Reconciliation Act in 1987 (OBRA 1987). It revamped the quality assurance system for nursing facilities by changing the focus of the regulation and improved the inspection and enforcement process. One of the goals of OBRA 1987 is to elevate quality of life concerns to the same level as quality of care because a nursing facility that meets federal and state inspection standards may still be an uninviting and unpleasant place to live and work. Directing nursing facilities towards deinstitutionalizing services and individualizing care are the core objectives of OBRA 1987 requirements.

The OBRA 1987 reforms established minimum quality of care standards for nursing facilities, use of a resident assessment instrument to assist in assessment and care planning, as well as specific residents' rights. **Figure 1** shows selected residents' rights related to improving the quality of life and providing individualized care that are contained in OBRA 1987.

OBRA 1987 also changed the inspection process from a paper record review to a process that incorporated the direct observation of care and communication with residents, their families, and staff. A broader range of enforcement tools was developed that includes financial penalties, blocks on payments for new admissions or all residents, the ability to appoint new management to take over failing facilities, and in extreme cases, termination from participating in Medicaid and Medicare programs.

With the enactment of OBRA 1987, the basis for the national movement known as "culture change" began. It was facilitated by nursing facilities and prominent professionals networking across the country and advocating for person-centered care and the full implementation of OBRA principles. Culture change is the umbrella name for activities that change the institutional culture by allowing residents to decide their own routines and schedules and increase their involvement in their care. It also cultivates interdisciplinary collaboration among staff to achieve increased resident participation. The goal of the culture change movement is to assist nursing facilities to de-institutionalize the way they provide care and make it more individualized or person-centered. Three elements shared by culture change models of care are: person-centered care practices, workforce improvement practices, and the use of objective data for continuous quality improvement efforts. Research evaluating the use of person-centered care practices demonstrates that increasing residents' choice and involvement can: (1) reduce behavioral incidents between residents, (2) lower rates of depression, (3) improve residents' emotional well being, and (4) decrease the decline in functional abilities.

Since the enactment of OBRA 1987, regulators, providers, policymakers, and long term care advocates have encountered regulatory and other challenges associated with transforming the physical environment of nursing facilities into more home-like environments. In 2008, in response to this feedback, CMS met with long term care stakeholders to discuss possible solutions. The outcome of these meetings resulted in CMS issuing interpretive guidelines with detailed information for state surveyors to assess compliance with OBRA 1987 regulation on issues related to the physical environment, resident rights, and resident health and safety. The guidelines clarify to nursing facility providers that they

FIGURE 1
SELECTED NURSING FACILITIES' RESIDENTS' RIGHTS IN THE OMNIBUS BUDGET RECONCILIATION ACT, 1987

- Right to freedom from abuse, mistreatment, and neglect;
- Right to freedom from physical/chemical restraints;
- Right to privacy;
- Right to accommodation of medical, physical, psychological, and social needs;
- Right to participation in resident and family groups;
- Right to be treated with dignity;
- Right to exercise self-determination;
- Right to telephone access with privacy;
- Right to notification before a room or roommate change;
- Right of married couples to share a room if desired;
- Right to communicate freely;
- Right to participate in the review of one's care plan, and to be fully informed in advance about any changes in care, treatment, or change of status in the facility;
- Right to voice grievances without discrimination or reprisal;
- Right to have access to a state long-term care ombudsman;
- Right to a personal attending physician;
- Right that a resident will be transferred or discharged only for reasons of health, safety, welfare of the resident or other residents, nonpayment, or facility closure; and
- Right to appeal decision in case of transfer or discharge from the nursing home.

Source: Department of Aging and Disability Services; Pioneer Network.

should begin or continue to de-institutionalize their physical environments and to provide person-centered care that emphasizes individualization, relationships, and a psychosocial environment that is comfortable for each resident.

NURSING FACILITY INSPECTIONS

Current federal law requires nursing facilities to be subject to a "periodic, resident-centered inspection which gathers information about the quality of service furnished in a facility to determine compliance with the requirements" for participation in the Medicaid and Medicare programs. An inspection may not occur more than 15 months from the date of the facility's last inspection. The Centers for Medicaid and Medicare Services (CMS) contracts with states to conduct the federal survey inspections.

In Texas, staff from the Department of Aging and Disability Services (DADS) conducts the federal survey to hold nursing facility providers accountable to federal standards that are meant to ensure the safety of more than 87,000 Texans. For efficiency, inspections for federal and state licensing occurs concurrently. Inspections are always unannounced, last approximately three to four days, and are conducted by a team of professionals that must include at least one registered nurse. Typically, the survey team consists of three or four staff and may include physicians; physician assistants; nurse practitioners; physical; speech; or occupational therapists; dieticians; sanitarians; engineers; social workers; or other relevant professional staff. Architects or other fire safety specialists evaluate the facility for its compliance with fire and safety code standards. Upon entering the facility, the survey team leader meets with the administrator or designee while the other survey team members immediately go to a pre-assigned area to observe how staff delivers care and the interactions between staff and residents. During the federal inspection, state surveyors tour the nursing facility and observe the care given to residents. The surveyors talk with residents and their families about what life is like in the facility, and meet with its residents' council or ombudsman. In addition to reviewing residents' records and other documents to ensure compliance, surveyors also meet with administrative and direct care staff. The agency provides the survey results to facility administrators no later than 10 business days after the last day of inspection.

The current regulatory system has been in place for more than 20 years and focuses on deterrence by holding providers accountable for meeting a minimum standard that is enforced by financial and administrative sanctions. The intent of the system is to enforce minimum standards rather than to foster quality improvement, highlight good quality once minimum standards are met, or provide assistance to achieve and maintain excellence. Therefore, because the system does not encourage innovation, providers may face difficulty when implementing best practices to improve physical environments and organizational systems prescribed in OBRA 1987.

A 2008 Commonwealth Fund Long Term Care Opinion Leader Survey found that among long-term care specialists, nursing facility providers were three times more likely than consumer advocates or policymakers to perceive regulation as the greatest barrier to implementing person-centered care practices. Nursing facility providers ranked regulation as the number-one barrier, above cost and senior leadership resistance, to implementing person-centered care practices. Researchers posit that the providers' beliefs about significance of regulation influenced their perception more than the actual knowledge of regulations. Nonetheless, providers participating in a follow-up focus group to the Long Term Care Opinion Leader Survey described "the regulatory environment as posing significant impediments since its framework is largely around identifying... deficiencies..."

In 2007, The Commonwealth Fund conducted the National Survey of Nursing Homes to assess the extent by which facilities are implementing person-centered care and culture change activities. The Commonwealth Fund surveyed a nationally representative sample of nursing facilities. Thirty-one percent of nursing facilities described their facility as having adopted culture change or person-centered care activities "completely or for the most part," while approximately 68 percent described their facility as having adopted few aspects of culture change or not at all and may or may not have the support of facility leadership.

CMS is aware of these perceptions about regulations conflicting with best practices or innovative care. CMS has sought to clarify these perceptions through various methods, such as: (1) providing training about person-centered care practices to state survey inspectors; (2) issuing additional interpretive guidelines related to the physical environment, residents' rights, and resident health and safety in nursing facilities; (3) participating in long-term care conferences; (4) developing webinars and webcasts for state inspection survey staff; and (5) developing an assessment instrument for providers to measure their facility's implementation of person-centered care practices.

RHODE ISLAND'S INDIVIDUALIZED CARE PILOT

Rhode Island developed an innovative pilot project to use the regulatory process to enhance individualized care and bring consistent attention to quality of life regulations contained in OBRA 1987 to their state survey inspectors and nursing facility providers. Rhode Island officials consider the Individualized Care Pilot (ICP) project's simple design to be one of its most powerful assets. The pilot project used the annual survey inspection process to ask providers targeted, detailed questions about person-centered care, thereby accomplishing two positive results; educating state survey staff about the provision of individualized care and conveying the message to providers that state regulators viewed quality of life as a priority.

PILOT PROJECT SCOPE AND DESIGN

Leadership from Rhode Island's State Survey Agency (SSA), the provider community, and other interested stakeholders collaborated to explore other methods for improving nursing facility residents' lives while adhering to federal and state regulations. Based on their research and collaboration, SSA officials established the ICP. The duration of the project was six months, (November 2007 to April 2008). During that period, all Rhode Island nursing facilities that received their annual federal inspection were included in the ICP. In all, 51 facilities participated in the pilot project, and 221 residents and 315 direct care staff interviews were conducted.

As part of the ICP, state survey staff consistently asked additional questions of residents and staff and observed targeted quality of life indicators during nursing facility federal and state inspections. Educational meetings with the Rhode Island Quality Improvement Organization (QIO) followed these activities to provide information and resources to nursing facility administrators about person-centered care. To help educate the providers about person-centered care practices, a confidential document, the Summary of Survey Data report, was provided to surveyed facilities about data collected during the inspection process related to quality of life. The Summary of Survey Data report documented information from selected interviews and observations, including notations of practices that appeared to support person-centered care. This report was separate from the required report of compliance or non-compliance issued by the SSA and was specific to each facility.

Rhode Island SSA officials sought CMS approval to grant the ICP "pilot" status because the federal survey process was used as the structure for the project. The ICP project added specific survey questions related to person-centered care. The project also modified the survey process to include an educational session conducted by the state QIO that occurred during the recertification survey. Moreover, the granting of "pilot" status by CMS allowed Rhode Island SSA survey staff the ability to not cite providers for deficiencies for the official record if they were directly related to the specific questions in the ICP project. The only exception to this was if surveyors identified an "immediate jeopardy" situation. Otherwise, all noncompliant practices related to the ICP were investigated and documented according to existing guidelines for citing federal deficiencies and were submitted to each nursing facility as part of a non-regulatory Summary of Survey Data report.

The ICP project highlighted specific areas through guidance from a technical advisory panel developed to oversee it. The areas chosen to monitor during the survey process already had a regulatory link. **Figure 2** shows the areas selected for monitoring and their corresponding federal regulatory link or commonly known as an F-tag.

The selected areas included resident choice of daily schedules, a home-like environment, and staff-resident relationships. However, ICP project coordinators also included questions related to consistent staffing assignments, which is not a regulatory requirement but was determined to be an essential component to person-centered care. ICP staff and the technical advisory panel decided that it would be more effective for total system change if they targeted a limited number of person-centered care practices during a short period. Additionally, consideration was given for any extra time that would be required of survey staff for the ICP project. A key factor in the selection of the monitoring areas was the ability to gather information from various stakeholders within a nursing facility about the same topic. For example, surveyors could ask a resident, a direct care worker, and a facility administrator about the resident's waking/sleeping preference, thereby allowing surveyors to see the same topic from various perspectives.

The Quality Improvement Organization (QIO) of Rhode Island played a pivotal role in the success of ICP project. One of the required core functions of each state's designated QIO is to improve the quality of care of Medicare beneficiaries. CMS view QIOs as an important resource in its effort to improve the quality and efficiency of care received by Medicare beneficiaries. QIOs contract with CMS for a three-year period and are located in every state. They are private, mostly not-for-profit organizations, which are staffed by

FIGURE 2
SELECTED AREAS MONITORED IN INDIVIDUALIZED CARE PILOT PROJECT AND THE ASSOCIATED FEDERAL REGULATIONS

AREA	FEDERAL REGULATORY TAG (F-TAG)
Resident Schedules and Choices for Sleeping, Bathing, and Eating	F-241 – Resident Dignity and Respect of Individuality
	F-242 – Self Determination; Right to Make Choices
	F-246 – Reasonable Accommodation of Needs/Preferences
Personalized Environment and Sound Levels	F-241 – Resident Dignity and Respect of Individuality
	F-246 – Reasonable Accommodation of Needs/Preferences
	F-252 – Safe, Clean, Home-like Environment
	F-250 – Medically related Social Services
	F-258 – Maintenance of Comfortable Sound Levels
Staff/Resident Relationships	F-241 – Resident Dignity and Respect of Individuality
	F-246 – Reasonable Accommodation of Needs/Preferences
	F-223 – Free from Abuse/Involuntary Seclusion

Source: Centers for Medicaid and Medicare Services; Department of Aging and Disability Services; Rhode Island Department of Health.

doctors and other healthcare professionals who are trained to review medical care, assist beneficiaries with complaints about the quality of care, and implement improvements in the quality of care. The Rhode Island SSA partnered with their state QIO to provide resources and educational materials to nursing facility providers who wanted to become more person-centered. This partnership, allowed the state surveyors to maintain their role as objective evaluators of compliance and not as consultants. Conversely, it allowed the QIO to assume an advisory role and provide educational resources for facilities that wanted to use their expertise.

While the ICP project may have started out as a one-time collaboration between the state and the QIO, it subsequently developed into an ongoing partnership. This partnership resulted in many innovative activities in the advancement of person-centered care. Some activities include: on-site meetings with nursing facility staff to discuss person-centered care, joint presentations with SSA staff about perceived regulatory barriers to person-centered care, and "brown bag lunch" meetings at nursing facilities to encourage the cross pollination of person-centered practices.

Consistency in the messages and information conveyed during the ICP project by QIO staff and surveyors was important to ensure providers heard the same information from both parties, therefore a 20-hour training program was established for Rhode Island surveyors at the beginning of the pilot project. The goals of the training were to educate surveyors about person-centered care topics targeted for the ICP project and encourage surveyors to examine their attitudes regarding the survey inspection process, person-centered care, and how interviews with residents, their families, and facility staff are conducted. Survey staff also received training on the use of ICP forms and protocols. Before the training, ICP staff discovered that surveyors, like nursing home personnel, were comfortable and familiar with the institutional model of care that requires residents to adapt to institutional rules and schedules. As a result, the training emphasized what person-centered care practices and systems might look like in a nursing facility and which existing regulations support these activities. Surveyors needed to look beyond the institutional model of care to know what evidence might exist that would indicate non-compliance with regulations related to resident choice, staff-resident relationships, and a personalized, home-like environment.

PILOT PROJECT RESULTS

At the end of the pilot project, surveyors completed a questionnaire about various topics related to the ICP. Compared to before the ICP project, 95 percent of surveyors agreed or strongly agreed that they have a greater understanding of the regulations related to person-centered care and 68 percent agreed or strongly agreed that the ICP project helped them do a better job of assessing regulatory compliance in all areas.

According to The Commonwealth Fund evaluators, the results of the ICP project indicate that it successfully helped facility staff to understand, consider, and implement

person-centered care. Pre- and post-test surveys were sent to all nursing facilities in Rhode Island. Fifty-three percent of nursing facilities responded to both surveys and half were participants in the pilot project. Facilities participating in the pilot did better than those that did not participate. Residents' access to person-centered care activities increased significantly across six of the eight surveyed areas between the pre-and post-tests. The most significant improvement occurred by facility staff allowing residents the choice to eat when they want. Bringing resident choice to bathing/showering days and times also improved from before the ICP project, as did allowing residents to access small appliances for preparing their meals. Giving residents increased access to food from a refrigerator and allowing them to request foods not on the menu increased in one-third of the facilities, but was not statistically significant. Of the nursing facilities inspected during the ICP project, surveyors found seven deficiencies in seven separate nursing facilities based only on the observations and questions. Five deficiencies were related to F-tag 242, Self Determination/Right to Make Choices and two were related to F-tag 258, Maintenance of Comfortable Sound Levels.

Resident involvement in nursing facility decision-making also increased significantly between pre- and post-test surveys. The largest of these improvements occurred for residents providing input in decisions about staff working in their part of the facility. Residents' input increased regarding common area decorations and meal schedules. Seventeen percent of facilities moved forward with consistent assignment for direct care staff, while 40 percent of facilities began including direct care workers and residents as a formal part of the senior management team.

As part of the post-test survey, nursing facility administrators were asked to assess the effect the ICP project had on the care they provide to residents. Fifty-five percent of the administrators reported that the project had helped them to implement or continue to implement changes to make care more person-centered. Twenty-six percent of the administrators reported that it had encouraged them to think of ways to make their facility more person-centered, while 19 percent of administrators reported the pilot had no effect.

Despite a positive evaluation of the ICP project by The Commonwealth Fund, some study limitations exist. Rhode Island is a small state and the results may not be generalized to all states. Before the ICP, the Rhode Island SSA had already been active in advancing person-centered care practices and according to The Commonwealth Fund, the state measures higher than average in the ability to provide person-centered care when compared to national averages of nursing facilities. However, according to project evaluators these differences could imply two results: (1) the positive changes observed from the pilot over a short period may be harder to achieve elsewhere or (2) the potential for rapid change is even greater in states where person-centered care is not well known. Notwithstanding the limitations, evaluators of the pilot project believe the ICP could affect provider change through its unique multi-pronged approach through the federal survey inspection process.

TEXAS EFFORTS TO IMPLEMENT OBRA 1987 PRINCIPLES

In 2006, DADS regulatory staff and long-term care ombudsmen began discussions with nursing facility providers about person-centered care and culture change practices. DADS Educational and Regulatory Services partnered with Leading Age Texas (formally known as the Texas Association of Homes and Services for the Aging) and the Texas Health Care Association to provide ongoing training about culture change to providers and DADS survey inspectors. Since then, DADS staff has served on local committees for national and state organizations that focus on person-centered care practices, such as Advancing Excellence in America's Nursing Homes and most recently on the Texas Culture Change Coalition. In 2010, DADS began an agency wide culture change initiative to promote and support nursing facility providers to transform the traditional institution-directed culture to a person-centered culture. A steering committee for the initiative was formed and meets regularly to coordinate its efforts agency and statewide.

In 2011, DADS successfully launched, and continues to maintain, a website promoting culture change in Texas nursing facilities. The website offers consumers and their families, as well as providers, information about culture change and its implementation. Resources such as trainings and educational information and contact information for DADS' regional culture change liaisons are also available on the website. The culture change liaisons are staff located in each region of the state to assist providers and inspection survey teams by acting as resources of information about culture change and regulations supporting it. The DADS Commissioner demonstrates his support for the culture change effort and the benefits of person-centered care in an open letter to website visitors.

DADS has limited self-reported data from nursing facility providers regarding the implementation of person-centered

care practices and culture change models of care. Based on this lack of data and on informal and anecdotal information, DADS regulatory staff suspects that few nursing facility providers are implementing person-centered care and are fully implementing OBRA 1987 regulations and principles. Similar to other states' survey agencies, DADS continues to receive feedback and comments from nursing facility providers with concerns about federal regulations and surveyors' interpretation of them as barriers to implementing person-centered care and other innovative culture change models. In 2011, DADS conducted a five-question online survey to ask nursing facility providers about their person-centered care activities. The survey results revealed that providers perceive regulations and cost to be major barriers to implementing person-centered care activities. DADS is addressing the misperception that a capital investment is needed to implement culture change activities through webinars that feature other providers who have started a culture change process without significant cost. DADS also plans to offer additional trainings that demonstrate practical and low-cost or no-cost strategies to assist providers to begin the transition to person-centered care.

LEVERAGING TEXAS' NURSING HOME INSPECTIONS TO SUPPORT PERSON-DIRECTED CARE

Despite efforts by DADS thus far to fully implement OBRA 1987 principles and regulations, nursing facilities continue to perceive barriers to implementing innovative, person-centered care practices. DADS' current efforts to support nursing facility providers' transition to person-centered care practices and culture change models of care offer a foundation for replicating Rhode Island's ICP project in Texas.

Recommendation 1 would include a rider in the introduced 2014–15 General Appropriations Bill to direct DADS to implement in one or more regions of the state a person-centered care pilot project modeled on the Rhode Island ICP project. The pilot would use the regulatory inspection process to enhance nursing facility providers' knowledge and implementation of person-centered care practices and culture change models of care. In the course of developing the person-centered care pilot, DADS would be directed to use the tools the Rhode Island Department of Health developed to assist other states in replicating the ICP project. These items include a five-module Toolbox that outlines the project design and includes survey tools and educational components (**Figure 3**).

Accordingly, DADS would be directed to seek CMS approval as Rhode Island did for "pilot status" for a defined period so that deficiencies cited during this time that are identified solely through the questions and observations specific to the pilot project, unless immediate jeopardy conditions exist, are not documented for the federal record. The benefit of this status is that surveyors could identify deficiencies in providing person-centered care without penalizing the provider. This structure would give the surveyor and the provider an opportunity to learn about person-centered care.

To fulfill the educational partnership of the pilot project, DADS would be directed to partner with an entity whose mission and purpose is to train and implement culture change models of care and person-centered activities in long-term care facilities. DADS could use staff now assigned as culture change liaison staff to fulfill this function or other entities such as a culture change coalition, university researchers, or the state QIO. DADS and the state QIO have an established relationship through prior partnerships to provide culture change conferences and training opportunities. Texas' QIO is also scheduled to conduct activities related to improving consistent staff assignment and reducing turnover rates in nursing facilities through

FIGURE 3
INDIVIDUALIZED CARE PILOT TOOLBOX, 2008

MODULE	TITLE	PURPOSE
1	Recommendations and Dilemmas	Identifies the challenges the different stakeholders face when a provider changes policy to become more person-centered.
2	Design Process	Identifies the steps and activities taken by the state survey agency to develop the pilot project.
3	Surveyor Training	Identifies how training was conducted and provides information about the training collaborative developed with their educational partner.
4	Survey Tools	Includes the survey documents and forms.
5	Educational Materials	Includes information and educational materials used for nursing facility providers.

Source: Rhode Island Department of Health.

fiscal year 2014. Both topics relate to a nursing facility's ability to provide person-centered care.

The rider would direct DADS to evaluate the Person-Centered Care pilot project and report its findings to the Governor and the Legislative Budget Board by August 31, 2015. The evaluation should include pre and post test measures of areas targeted for improvement, impact on nursing facility administrators and state survey staff, and any other measure DADS determines is needed to determine the pilot's effectiveness.

FISCAL IMPACT OF THE RECOMMENDATION

Implementation of Recommendation 1 would have no significant fiscal impact and could be accomplished using the agency's existing resources. Although Rhode Island SSA received a $250,000 grant to assist with implementing their ICP project, Texas can adapt much of their work, such as survey instruments and educational materials to implement its own person-centered care pilot project. According to Rhode Island officials, they used the grant money to hire a temporary project coordinator and for the development and dissemination of surveyor training supplies and materials, as well as for attendance at culture change conferences. Unlike Texas, Rhode Island did not have additional staff at the state survey agency to assist with the ICP project. They are limited to 18 survey staff to survey and inspect 86 nursing facilities.

As of fiscal year 2011, there were 1,211 nursing facilities in Texas and 307 staff to enforce state and federal regulations through the annual state and federal survey process in addition to other staff, such as quality monitors and facility liaisons, at DADS who assist with long-term efforts to improve the quality of care. Unlike Rhode Island, DADS may use its quality monitoring staff and the nine regional facility liaisons who also act as culture change liaisons to implement a person-centered-care pilot project. The liaisons' function is to act as a resource in a non-compliance role in providing information, guidance, liaison support between DADS and nursing facilities. The quality monitors' role is to identify opportunities to improve services and supports by using proven interventions, such as person-centered care and culture change activities. By using the existing quality-monitoring program or the facility liaisons, DADS has the resources to implement Recommendation 1.

According to DADS, surveyor inspectors received training about culture change models of care since fiscal year 2003. Therefore, DADS' staff may need a limited amount of additional training. Most of this training would be specific to the use of the survey instruments. In choosing a training partner to conduct follow-up technical assistance for selected nursing facilities, DADS may choose to partner with the state QIO or the state culture change coalition. Both organizations have recently provided other training services to the agency's staff and providers.

The introduced 2014–15 General Appropriations Bill includes a rider to implement this recommendation.

USE ALTERNATIVE SETTINGS TO REDUCE FORENSIC CASES IN THE STATE MENTAL HEALTH HOSPITAL SYSTEM

Individuals under forensic commitment fall into two categories. The first category includes individuals charged with a misdemeanor or felony offense who are ordered by the court to receive mental health treatment because they are incompetent to stand trial. The second category includes individuals acquitted of an offense that involved dangerous conduct because a judge or jury has determined them to be not guilty by reason of insanity and who are ordered by a court to receive mental health treatment. Individuals under forensic commitment must be committed to a mental health facility or residential care facility or they may be ordered to participate in an outpatient treatment program. Individuals under forensic commitment who have been committed to a mental health facility are primarily served at state mental health facilities the Texas Department of State Health Services manages, but may also be served at community mental health hospitals funded in part by the agency.

The state mental health hospital system in Texas, which includes 10 state mental health facilities and state-funded mental health beds at hospitals not operated by the Texas Department of State Health Services, does not have the capacity to meet current demand for services. As a result, some individuals under forensic commitment have historically been placed on a waiting list maintained by the agency. Some individuals under civil commitment may also be unable to access care at a state mental health facility in a timely manner. Meanwhile, the state treats certain individuals under forensic commitment in the state mental health hospital system who could potentially be served in a less expensive alternative setting. Alternative settings, which include outpatient competency restoration, jail-based competency restoration, residential rehabilitation units, and conditional release, could help reduce demand for inpatient treatment, but access to and use of alternatives is limited.

Serving certain individuals under forensic commitment in alternative settings instead of the state mental health hospital system could result in cost avoidance for the state. To avoid some of the costs associated with treating these individuals in the state mental health hospital system, the state should take steps to increase access to and use of alternatives to inpatient treatment. Expanding the use of alternatives should help ensure individuals under forensic commitment are served in the most cost-effective setting.

FACTS AND FINDINGS

- ♦ The total number of beds allocated for civil and forensic patients at state mental health facilities in fiscal year 2012 was 2,501 (1,561 civil beds and 940 forensic beds).
- ♦ The average daily census, or the average number of beds occupied each day, across all state mental health facilities and all commitment types was 2,323 in fiscal year 2012. On average, 38.1 percent of the beds at state mental health facilities were occupied by forensic commitments on any given day in fiscal year 2012. Approximately three-quarters of the beds occupied by forensic commitments were for defendants found incompetent to stand trial.
- ♦ The average annual cost per case at state mental health facilities for defendants found incompetent to stand trial in fiscal year 2012 was $50,520 in All Funds compared to $95,567 in All Funds for not guilty by reason of insanity commitments, and $15,156 in All Funds for civil commitments.
- ♦ On any given day, approximately 147 people are on either the maximum security unit waiting list or the forensic clearing house waiting list. The average time on the waiting list is 41 days. A total of 1,802 forensic cases were placed on a waiting list at some point during fiscal year 2012.
- ♦ A recent court ruling in Texas found that keeping incompetent individuals in jail for an unreasonable amount of time prior to being admitted to a state mental health facility or residential health facility to receive treatment violated their due process rights. The court also required the Texas Department of State Health Services to make a bed available for incompetent detainees no later than 21 days from the date the agency receives notice of a criminal court's commitment order.

CONCERNS

- ♦ The state mental health hospital system in Texas does not have the capacity to meet current demand for services. Statute does not provide explicit authority for the operation of jail-based competency

restoration or conditional release programming that is less expensive than treatment in the state mental health hospital system. Also, the state may not be maximizing its use of existing outpatient competency restoration programs and residential rehabilitation units. As a result, access to and use of less-expensive alternative settings, which could help reduce demand for inpatient treatment in Texas, is limited.

- Judges, prosecuting attorneys, and criminal defense attorneys do not regularly receive education on alternatives to inpatient treatment that may be appropriate for certain individuals under forensic commitment. As a result, judges and other professionals involved with forensic commitment cases may be unaware of alternatives to inpatient treatment that could result in cost avoidance for the state.

RECOMMENDATIONS

- **Recommendation 1:** Amend statute to provide access to jail-based competency restoration for individuals found incompetent to stand trial by: (1) authorizing the Texas Department of State Health Services to partner with counties to establish jail-based competency restoration programs that do not result in an increase in overall spending on state-funded mental health treatment; (2) requiring that the Texas Department of State Health Services implement a quality review process for state-sponsored jail-based competency restoration programs whereby the programs must meet established criteria to ensure they provide high quality mental health treatment comparable to the quality of treatment that would otherwise be provided in an inpatient setting; and (3) authorizing the courts to order defendants who are found incompetent to stand trial to receive state-sponsored jail-based competency restoration.

- **Recommendation 2:** Amend statute to provide access to conditional release for certain individuals under forensic commitment by: (1) requiring the Texas Department of State Health Services to implement a conditional release pilot program based on successful models in other states, evaluate the cost-effectiveness of the pilot, submit a report on the evaluation findings to the Legislative Budget Board and the Office of the Governor by December 1, 2014, and expand the program to additional sites only if the program is effective and does not result in an increase in overall spending on state-funded mental health treatment; and (2) authorizing the courts to order individuals under forensic commitment to participate in a state-sponsored conditional release program.

- **Recommendation 3:** Include a contingency rider in the introduced 2014–15 General Appropriations Bill that would authorize the Texas Department of State Health Services to use funds appropriated for hospital facilities and services for: (1) jail-based competency restoration for individuals found incompetent to stand trial; and (2) conditional release programs for certain individuals under forensic commitment.

- **Recommendation 4:** Include a rider in the introduced 2014–15 General Appropriations Bill that would authorize the Court of Criminal Appeals to use funds appropriated for judicial education to educate judges, prosecuting attorneys and criminal defense attorneys involved with forensic commitment cases on alternatives to inpatient treatment.

DISCUSSION

Individuals under forensic commitment fall into two categories. The first category includes individuals charged with a misdemeanor or felony offense who are ordered by the court to receive mental health treatment because they are incompetent to stand trial (IST). All individuals charged with a misdemeanor or felony offense must be competent to stand trial. In the 1960 U.S. Supreme Court decision *Dusky v United States,* the court defined the test of competency to stand trial as whether the accused has "sufficient present ability to consult with his lawyer with a reasonable degree of rational understanding and whether he has a rational as well as factual understanding of the proceedings against him." In short, competency means the defendant both understands the charges against him and has sufficient mental ability to help in his or her own defense. The Texas Code of Criminal Procedure mirrors the U.S. Supreme Court ruling and also states that a defendant is presumed competent to stand trial and shall be found competent to stand trial unless proved incompetent by a preponderance of the evidence.

Pursuant to state law, when a defendant's competency to stand trial is in doubt, the courts must follow a specific competency determination process before the defendant can be brought to trial. Competency to stand trial is generally determined during a pretrial examination that includes consideration of whether the defendant has a diagnosable

mental illness or is a person with intellectual and developmental disabilities and an assessment of the defendant's capacity to participate in criminal proceedings. If the defendant is found IST, the court must commit the defendant to a mental health facility or residential care facility or release the defendant on bail and order their participation in an outpatient treatment program to attain competency to stand trial. Statute requires that IST defendants charged with a misdemeanor who are not a danger to others and can be safely treated in an available outpatient treatment program be committed to such a program. IST defendants who meet the same criteria, except who are charged with a felony, may be committed to an outpatient treatment program. While a person may be found IST because of a mental illness or for other reasons such as an intellectual and developmental disability, this report focuses primarily on the former.

The second category that individuals under forensic commitment fall into includes individuals acquitted of an offense that involved dangerous conduct because a judge or jury has determined them to be not guilty by reason of insanity (NGRI) and who are ordered by a court to receive mental health treatment. Pursuant to state law, the courts must follow a specific process to determine the defendant's sanity. The judge or jury can only determine that a defendant is NGRI if the prosecution has established beyond a reasonable doubt that the alleged conduct was committed and the defense has established by a preponderance of the evidence that the defendant was insane at the time of the alleged conduct. If the defendant is acquitted of a criminal offense because a judge or jury has determined them to be NGRI, the disposition of the acquitted person will depend on whether the offense involved dangerous conduct. Dangerous conduct includes conduct that caused serious bodily injury to another person, placed another person in imminent danger of serious bodily injury, or consisted of a threat of serious bodily injury to another person through the use of a deadly weapon. Individuals acquitted of an offense which involved dangerous conduct may be committed by a court to an appropriate facility for inpatient treatment or residential care, ordered to receive outpatient or community-based treatment, transferred to an appropriate court for civil commitment proceedings, or discharged and immediately released. Individuals acquitted of an offense which did not involve dangerous conduct may be transferred to an appropriate court for civil commitment proceedings.

STATE MENTAL HEALTH FACILITIES

Individuals under forensic commitment who are committed to a mental health facility may be served at a state mental health facility (SMHF) managed by the Texas Department of State Health Services (DSHS). DSHS manages 10 SMHFs, including eight state-owned mental health hospitals, one state-owned inpatient residential treatment facility for adolescents (i.e., Waco Center for Youth), and the Rio Grande State Center that provides inpatient mental health services. Except for the Waco Center for Youth and the Rio Grande State Center, all SMHFs serve IST patients. The SMHFs that primarily serve NGRI patients include North Texas State Hospital, Rusk State Hospital, Kerrville State Hospital, and Big Spring State Hospital. If there are no beds available at these hospitals, NGRI patients may be placed at Austin State Hospital, San Antonio State Hospital, Terrell State Hospital, or El Paso Psychiatric Center.

Individuals under forensic commitment at SMHFs receive medical and psychological services to treat and stabilize their condition. IST patients also receive services specific to the competency restoration process, including educational counseling to help them understand how the legal process works, the charges brought against them, possible court dispositions, and their rights under the law. SMHFs also serve individuals on civil commitments, including individuals who voluntarily admit themselves for treatment as well as individuals who the court has ordered to receive inpatient mental health treatment.

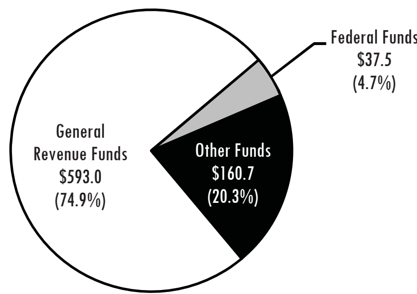
As shown in **Figure 1**, the estimated amount to be expended on SMHFs is $791.2 million in All Funds for the 2012–13 biennium. General Revenue Funds constitute $593.0 million, or 75 percent, of the 2012–13 estimated biennial expenditures for SMHFs. Of this amount, $20.2 million are General Revenue Funds Certified as Match for Medicaid. Federal Funds constitute $37.5 million, or 4.7 percent, of the 2012–13 estimated biennial expenditures for SMHFs. This amount includes $28.9 million in Medicaid funding. Pursuant to current federal law, Medicaid funding appropriated to SMHFs can only be used to serve children and adolescents age 21 and younger and eligible adults age 65 and older. Other Funds account for 20.3 percent of the 2012–13 estimated biennial expenditures for SMHFs and total $160.7 million for the biennium. SMHFs may also receive funding from third-party payers such as Medicare and private insurance.

DSHS contracts with 39 local mental health authorities (LMHAs) to ensure the provision of mental health services in

FIGURE 1
ESTIMATED EXPENDITURES FOR STATE MENTAL HEALTH FACILITIES BY METHOD OF FINANCE, 2012–13 BIENNIUM

IN MILLIONS

TOTAL = $791.2 MILLION



SOURCE: Legislative Budget Board.

communities across Texas. LMHAs serve as the entry point to SMHFs and are responsible for managing the use of SMHF beds for their designated regions. LMHAs manage use of the SMHF bed days that are allocated to them through the State Hospital Allocation Methodology.

Figure 2 shows the number of beds allocated for civil and forensic patients at each SMHF in fiscal year 2012. The total number of beds allocated for civil and forensic patients at SMHFs in fiscal year 2012 was 2,501 including 1,561 civil beds and 940 forensic beds. Although forensic beds are specifically designated to serve forensic patients, including IST and NGRI commitments, civil beds can also be used for these patients.

The average daily census refers to the average number of beds that are occupied each day and is calculated by dividing the total number of inpatient days across all patients at SMHFs in a given year by 365 days. The average daily census, or the average number of beds occupied each day, across all SMHFs and all commitment types was 2,323 in fiscal year 2012. As shown in **Figure 3**, on average, 38.1 percent of the beds at SMHFs were occupied by forensic commitments (i.e., IST and NGRI) on any given day in fiscal year 2012. Approximately three-quarters of the beds occupied by forensic commitments were for IST commitments.

Figure 4 shows the number and percentage of cases by commitment type at SMHFs in fiscal year 2012. Although the percentage of beds occupied by civil commitments on any given day at SMHFs was higher than the percentage occupied by forensic commitments, there was an even greater percent difference between civil versus forensic cases during fiscal year 2012. Civil commitments typically involve shorter lengths of stay in SMHFs, and so there is greater patient turnover of civil beds. As shown in **Figure 5**, the average number of days per case for civil commitments in fiscal year 2012 was 36 days compared to 120 days for IST commitments

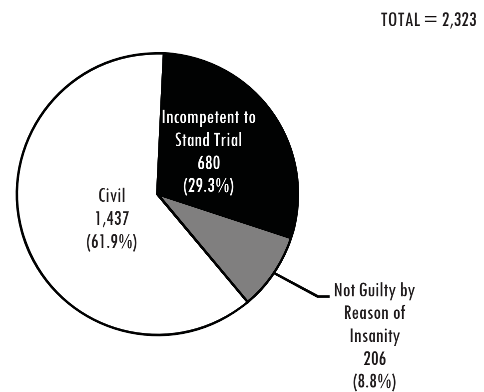
FIGURE 2
NUMBER OF BEDS ALLOCATED FOR CIVIL AND FORENSIC PATIENTS AT STATE MENTAL HEALTH FACILITIES IN TEXAS FISCAL YEAR 2012

STATE MENTAL HEALTH FACILITY	CIVIL BEDS	FORENSIC BEDS	TOTAL NUMBER OF BEDS
Austin State Hospital	261	38	299
Big Spring State Hospital	122	78	200
El Paso Psychiatric Center	58	16	74
Kerrville State Hospital	0	202	202
North Texas State Hospital	265	375	640
Rio Grande State Center	55	0	55
Rusk State Hospital	210	125	335
San Antonio State Hospital	220	82	302
Terrell State Hospital	292	24	316
Waco Center for Youth	78	0	78
Total	**1,561**	**940**	**2,501**

SOURCE: Texas Department of State Health Services.

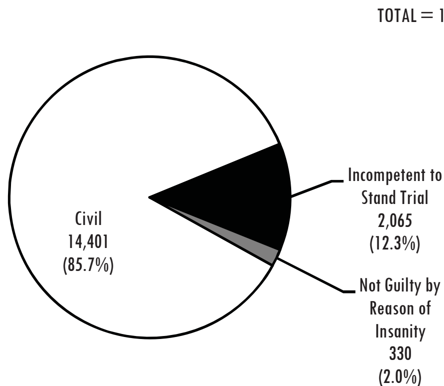
FIGURE 3
AVERAGE DAILY CENSUS BY COMMITMENT TYPE AT STATE MENTAL HEALTH FACILITIES IN TEXAS, FISCAL YEAR 2012

TOTAL = 2,323



SOURCE: Legislative Budget Board.

FIGURE 4
NUMBER OF CASES BY COMMITMENT TYPE AT STATE MENTAL HEALTH FACILITIES IN TEXAS, FISCAL YEAR 2012



Source: Legislative Budget Board.

FIGURE 5
AVERAGE NUMBER OF DAYS PER CASE AT STATE MENTAL HEALTH FACILITIES IN TEXAS BY COMMITMENT TYPE FISCAL YEAR 2012

COMMITMENT TYPE	AVERAGE NUMBER OF DAYS PER CASE
Civil	36
Incompetent to Stand Trial	120
Not Guilty by Reason of Insanity	227
Total	**50**

Source: Legislative Budget Board.

and 227 days for NGRI commitments. The average number of days per case is calculated by dividing total bed days by the number of cases. Only bed days for the referenced fiscal year are included in the calculation. As a result, the actual number of bed days for a case may be greater if treatment was provided in more than one fiscal year.

As shown in **Figure 6**, the average annual cost per case for IST commitments at SMHFs in fiscal year 2012 was $50,520 in All Funds compared to $95,567 in All Funds for NGRI commitments and $15,156 in All Funds for civil commitments. Although the average annual cost per case was higher for forensic commitments, estimated total annual spending in fiscal year 2012 was higher for civil commitments because there were a much greater number of civil than forensic cases (as shown in **Figure 4**). Estimated total annual spending is calculated by multiplying the total number of inpatient days in fiscal year 2012 for each commitment type by the average daily cost.

Figure 7 shows the number of discharged IST cases at SMHFs by outcome category for fiscal year 2012. For those cases where competency was restored, it took an average of 107 days for competency to be restored.

STATE-FUNDED MENTAL HEALTH BEDS AT NON-DSHS OPERATED HOSPITALS

In addition to SMHFs, DSHS purchases inpatient mental health services at non-DSHS operated hospitals. Non-DSHS operated hospitals include community mental health hospitals and other private hospitals. **Figure 8** shows the estimated number of state-funded civil and forensic beds at these hospitals as of September 2012. All of the state-funded forensic beds at these hospitals are for IST defendants.

The estimated amount to be expended on state-funded inpatient mental health services at non-DSHS operated hospitals is $139 million in General Revenue Funds for the 2012–13 biennium. General Revenue Funds are the only method of finance used to purchase state-funded beds at these hospitals.

FIGURE 6
AVERAGE COST PER CASE AND ESTIMATED TOTAL SPENDING IN ALL FUNDS AT STATE MENTAL HEALTH FACILITIES IN TEXAS BY COMMITMENT TYPE, FISCAL YEAR 2012

COMMITMENT TYPE	AVERAGE DAILY COST	AVERAGE NUMBER OF DAYS PER CASE	AVERAGE ANNUAL COST PER CASE	ESTIMATED TOTAL ANNUAL SPENDING (IN MILLIONS)
Civil	$421	36	$15,156	$220.9
Incompetent to Stand Trial	$421	120	$50,520	$104.5
Not Guilty by Reason of Insanity	$421	227	$95,567	$31.6

Source: Legislative Budget Board.

FIGURE 7
NUMBER OF DISCHARGED IST CASES AT STATE MENTAL HEALTH FACILITIES IN TEXAS BY OUTCOME CATEGORY, FISCAL YEAR 2012

OUTCOME CATEGORY	NUMBER OF CASES	PERCENTAGE OF TOTAL
Restored	938	74.9%
Not Restored	315	25.1
Total	**1,253**	**100.0%**

NOTE: Approximately 2.5 percent of discharged IST cases are not included due to incomplete record entry.
SOURCE: Texas Department of State Health Services.

FIGURE 8
ESTIMATED STATE-FUNDED MENTAL HEALTH BEDS AT NON-DSHS OPERATED HOSPITALS IN TEXAS, AS OF SEPTEMBER 2012

TYPE OF FACILITY	CIVIL BEDS	FORENSIC BEDS (NON- MAXIMUM SECURITY ONLY)	TOTAL
Community Mental Health Hospitals	252	120	372
Other Private Hospitals	90	0	90
Total	**342**	**120**	**462**

NOTE: The total number of beds may change due to contract negotiations and bed count clarifications.
SOURCE: Legislative Budget Board.

CAPACITY IN THE STATE MENTAL HEALTH HOSPITAL SYSTEM

The state mental health hospital system in Texas, which includes 10 SMHFs and state-funded mental health beds at non-DSHS operated hospitals, does not have the capacity to meet current demand for services. As a result, some individuals committed to a mental health facility because they are IST or NGRI have historically been placed on a waiting list maintained by DSHS while they wait to be admitted to the state mental health hospital system. While the waiting lists may include NGRI commitments, most of the individuals on these waiting lists are IST commitments. The waiting lists DSHS maintain include the following:

- The maximum security unit waiting list for IST and NGRI commitments and patients found dangerous from another SMHF waiting for entry to the Vernon campus at North Texas State Hospital.
- The forensic clearing house waiting list for IST and NGRI commitments waiting for entry to any other SMHF that serves individuals under forensic commitment or Montgomery County Hospital.

Figure 9 provides a snapshot of the number of individuals who were on either the maximum security unit waiting list or the forensic clearing house waiting list on August 31, 2012, and the average time on the waiting list by facility. Individuals may be removed from a waiting list because they are admitted to a facility, placed in an outpatient competency restoration program, or for another reason, such as their charges being dismissed. A total of 1,802 forensic cases were placed on a waiting list at some point during fiscal year 2012.

FIGURE 9
SNAPSHOT OF THE NUMBER OF PERSONS ON DSHS FORENSIC WAITING LISTS AND AVERAGE TIME ON WAITING LIST ON AUGUST 31, 2012

STATE MENTAL HEALTH FACILITY	NUMBER OF PERSONS ON WAITING LIST	AVERAGE TIME ON WAITING LIST (DAYS)
Austin State Hospital	8	15
Big Spring State Hospital	3	22
El Paso Psychiatric Center	6	55
Kerrville State Hospital	0	75
North Texas State Hospital	9	31
North Texas State Hospital – Vernon[1]	46	54
Rusk State Hospital	34	68
San Antonio State Hospital	15	47
Terrell State Hospital	20	25
Montgomery County Hospital	6	19
Total	**147**	**41**

[1]The number of persons waiting for entry to the Vernon campus at North Texas State Hospital reflects the average daily number of people on the maximum security unit waiting list.
SOURCE: Texas Department of State Health Services.

Some individuals under civil commitment may also be unable to access care at a SMHF in a timely manner. **Figure 10** shows the number and percentage of days in fiscal year 2012 that each SMHF was on diversion status. SMHFs on diversion status are too full to accept civil admissions and patients are diverted to another SMHF, a community mental health hospital, or an emergency room. If any part of a SMHF (e.g., adult female beds) does not have capacity for any part of a day, the SMHF is counted as being on diversion status for that day. On average, SMHFs were on diversion status on 36 percent of the days in fiscal year 2012. Diversion

FIGURE 10
DAYS ON DIVERSION STATUS BY STATE MENTAL HEALTH FACILITY, FISCAL YEAR 2012

STATE MENTAL HEALTH FACILITY	NUMBER OF DAYS ON DIVERSION STATUS	PERCENTAGE OF DAYS ON DIVERSION STATUS
Austin State Hospital	238	65%
Big Spring State Hospital	220	60
El Paso Psychiatric Center	163	45
Kerrville State Hospital	0	0
North Texas State Hospital	254	69
Rio Grande State Center	0	0
Rusk State Hospital	213	58
San Antonio State Hospital	203	55
Terrell State Hospital	29	8
Waco Center for Youth	0	0
Total	**1,320**	**36%**

Source: Texas Department of State Health Services.

data for community mental health hospitals is not available because it is not maintained by DSHS.

In 2007, Disability Rights Texas, a federally funded organization that advocates for people with disabilities, filed suit against DSHS on behalf of individuals in county jails waiting for access to SMHFs for competency restoration treatment. On January 23, 2012, the 419th District Court, Travis County, ruled in favor of the plaintiffs finding that keeping incompetent individuals in jail for an unreasonable amount of time prior to being admitted to a SMHF or residential health facility to receive treatment violated their due process rights as guaranteed by the Texas Constitution. The court further granted a permanent injunction against DSHS requiring that the agency make a bed available for IST detainees no later than 21 days from the date DSHS receives notice of a criminal court's commitment order. In response to the court ruling, DSHS implemented an approach that included adding maximum security and transitional forensic beds at SMHFs. The agency also contracted for civil beds at non-DSHS operated hospitals to free up capacity at SMHFs for forensic commitments.

ALTERNATIVES TO INPATIENT TREATMENT FOR FORENSIC CASES

Increasing access to and use of less expensive alternative settings for individuals under forensic commitment would allow the state to avoid some of the costs associated with treating these individuals in the state mental health hospital system. Alternatives to inpatient treatment for individuals under forensic commitment that could help reduce demand in the state mental health hospital system include outpatient competency restoration (OCR), jail-based competency restoration, residential rehabilitation units, and conditional release.

OUTPATIENT COMPETENCY RESTORATION

The Eightieth Legislature, 2007, passed legislation that amended the Texas Code of Criminal Procedure, Article 46B, to allow the court to release certain incompetent defendants on bail and order their participation in an outpatient treatment program, also referred to as OCR, with the specific objective of attaining competency to stand trial. IST defendants who are charged with a misdemeanor, not a danger to others, and can be safely treated in an available outpatient treatment program must be committed to OCR. IST defendants who meet the same criteria, except they are charged with a felony, may be committed to an outpatient treatment program. IST defendants who are charged with a felony that requires a maximum security commitment are not eligible for OCR. Local OCR staff consider criminal history, risk to self and the community, willingness to adhere to treatment plan, functional capacity, available community supports, and likelihood of restoration when deciding whether to recommend an individual for OCR. The judge, prosecuting attorney, and defense attorney must all agree to commit the individual to OCR.

As shown in **Figure 11**, DSHS provides funding to 11 entities that operate an OCR program. In fiscal year 2012, DSHS allocated $4 million in General Revenue Funds out of Community Mental Health Crisis Services for the OCR program. **Figure 12** shows utilization and spending data for the four OCR grantees in operation for all of fiscal year 2012. Complete spending and utilization data is not available for the OCR grantees that began operation in January 2012. The average annual cost per case for the OCR program in fiscal year 2012 ranged from $6,431 to $21,809 depending on OCR grantee compared to $50,520 for IST cases served at SMHFs.

FIGURE 11
OUTPATIENT COMPETENCY RESTORATION PROGRAMS IN TEXAS, FISCAL YEAR 2012

GRANTEE	DATE OF INITIAL DSHS FUNDING	COUNTIES SERVED
Austin Travis County Integral Care	January 2008	Travis
Center for Healthcare Services	January 2008	Bexar
MHMR of Tarrant County	January 2008	Tarrant
NorthSTAR/ValueOptions	January 2008	Dallas, Rockwall, Ellis, Navarro, Collin, Hunt, Kaufman
Andrews Center	January 2012	Henderson, Rains, Smith, Van Zandt, Wood
Community Healthcore	January 2012	Bowie, Cass, Gregg, Harrison, Marion, Panola, Red River, Rusk, Upshur
Emergence Health Network	January 2012	El Paso
Tri-County Services	January 2012	Liberty, Montgomery, Walker
Lubbock Regional MHMR	January 2012	Cochran, Crosby, Hockley, Lubbock, Lynn
MHMR Center of Nueces County	January 2012	Nueces
Spindletop MHMR	January 2012	Chambers, Hardin, Jefferson, Orange

Note: Neighboring counties may send their Incompetent to Stand Trial clients to existing Outpatient Competency Restoration programs with agreement between the committing court and the program.
Source: Legislative Budget Board.

FIGURE 12
NUMBER OF OUTPATIENT COMPETENCY RESTORATION CASES AND SPENDING, FISCAL YEAR 2012

GRANTEE	TOTAL ANNUAL SPENDING	NUMBER OF CASES	AVERAGE ANNUAL COST PER CASE	AVERAGE NUMBER OF DAYS PER CASE	AVERAGE DAILY COST
Austin Travis County Integral Care	$567,030	26	$21,809	33	$661
Center for Healthcare Services	661,287	44	15,029	117	128
MHMR of Tarrant County	357,608	22	16,255	91	179
NorthSTAR/ValueOptions	578,773	90	6,431	138	47
Total	**$2,164,698**	**182**	**$11,894**	**112**	**$106**

Source: Legislative Budget Board.

OCR improves continuity of care by building a natural support system in the client's home environment thereby reducing the risk of decompensation and recidivism. Since program inception in 2008 through fiscal year 2012, 685 OCR cases from the original four program sites have closed. Among the 685 closed OCR cases, 54.0 percent had their competency restored, 23.2 percent had their charges dismissed, 6.7 percent had their commitment extended, 18.4 percent were not restored, and 4.2 percent had another outcome such as reoffended. The percentages sum to more than 100 percent because an OCR case may have had more than one outcome, such as competency restored and charges dismissed. For those cases where competency was restored, it took an average of 144 days for competency to be restored.

JAIL-BASED COMPETENCY RESTORATION

Jail-based competency restoration programs provide competency restoration treatment in county jails instead of inpatient settings. While Texas does not currently allow IST defendants to receive competency restoration treatment in a jail-based setting, this type of program was implemented in California in January 2011. After conducting a competitive bidding process, the California Department of Mental Health (CDMH) entered into a contract with Liberty Healthcare Corporation, a private provider, to establish the program in San Bernardino County. Liberty, in turn, established a contractual relationship with San Bernardino County to implement the program at its county jail. CDMH pays Liberty $278 per day per commitment for competency restoration treatment services. Using part of this amount, Liberty pays San Bernardino County $68 per day per commitment for food and housing costs. In addition, Liberty pays for the cost of medications that is about $10 per day per commitment.

Under these agreements, Liberty provides intensive psychiatric treatment, acute stabilization services, and court-mandated services for IST patients. San Bernardino County jail officials provide security and management of the IST population held in the jail, as well as food and medication. Under the terms of its contract with CDMH, Liberty provides services to IST defendants in the jail for a maximum of 70 days. At that point, those who have not been restored to competency are transferred to the state hospital system where there treatment continues. According to a study completed by the California Legislative Analyst's Office (LAO) in January 2012, the jail-based program operating in San Bernardino County has had the following outcomes:

- Treatment starts in the jail almost immediately after an IST determination by a judge.
- Competency restoration is completed quickly for many IST defendants with an average length of treatment for those who have completed the program of 54 days instead of six to seven months in the state hospital system.
- None of the IST defendants brought to competency has returned to an incompetent status once returned to the courts.
- The number of individuals determined by judges to be IST and requiring competency restoration has decreased in San Bernardino County.
- San Bernardino County saves the costs it would otherwise incur for holding IST defendants in its jail until their transfer to a state hospital—approximately $5,000 for each IST commitment Liberty treats. During the first nine months of the program, San Bernardino County estimates that it saved a total of $200,000. The county incurs operating costs for food, clothing, and security for IST defendants who remain at the jail to receive competency restoration from Liberty, but all of these costs are offset by the payment of state funds passed through to them by Liberty.
- The state achieved a net savings of about $1.2 million during the first nine months of the program. This figure was calculated by subtracting the amount spent by the state on the Liberty contract (i.e., $300,000) from the amount of state hospital spending avoided (i.e., $1.5 million).
- The combined savings to both the state and the county bring the total public sector savings during the first nine months to approximately $1.4 million, or $70,000 in savings for each IST defendant treated by Liberty and released without placement in a state hospital. The savings is achieved because the daily amount the state pays per client for jail-based restoration (i.e., $278) is lower than the daily amount the state pays per client for competency restoration in a state hospital (i.e., $450) and the average length of treatment is shorter in the jail-based program.

In its study, the LAO recommended that the California Legislature expand the jail-based competency restoration program operating in San Bernardino County to other counties with a sufficient IST waitlist population. The LAO's recommendation is contingent on the California Legislature concluding that additional action is needed to reduce the IST wait list and availability of funding.

RESIDENTIAL REHABILITATION UNITS

The 2012–13 General Appropriations Act included a rider that directed DSHS to implement various strategies, including residential rehabilitation units, in an effort to avoid adding civil and forensic beds in the state mental health hospital system. Residential rehabilitation units are similar to inpatient hospital settings, but usually do not have locked doors during day time hours and have less staffing. Clients in residential rehabilitation units receive psychiatric care, nursing, social work, and dietary services. Patients also receive rehabilitation services with classes focusing on increased independence and a return to the community.

Existing patients at SMHFs on a civil or forensic commitment who are not at risk of self-harm, free from aggression towards others, able to take care of routine personal needs, willing to adhere to treatment plan and unit rules, a low risk of unauthorized departure, and who do not require routine skilled nursing care may be eligible for placement at a residential rehabilitation unit. These units target individuals found not guilty by reason insanity and defendants found incompetent to stand trial who are on extended commitments (i.e., at a SMHF for longer than one year), are unlikely to regain competency, and for whom the courts have not dismissed the charges or the commitment. On March 1, 2011, DSHS opened residential rehabilitation units at Big Spring State Hospital, Rusk State Hospital, and San Antonio State Hospital. **Figure 13** shows the number of residential

FIGURE 13
RESIDENTIAL REHABILITATION UNIT DATA, FISCAL YEAR 2012

RESIDENTIAL REHABILITATION UNIT BEDS	AVERAGE DAILY CENSUS	NUMBER OF CASES[1]	AVERAGE DAILY COST	AVERAGE ANNUAL COST PER CASE	ESTIMATED TOTAL ANNUAL SPENDING (IN MILLIONS)
120	105	174	$142	$31,298	$5.4

[1]Clients with multiple placements at a residential rehabilitation unit within one treatment episode at the SMHF are counted as one case.
Note: Spending data includes fiscal year 2011 facility costs and fiscal year 2012 staff salary costs.
Source: Texas Department of State Health Services.

rehabilitation unit beds at SMHFs as well as utilization and spending data.

CONDITIONAL RELEASE

Conditional release programs provide community-based support and treatment to certain forensic patients previously committed to inpatient settings. While Texas does not currently operate a conditional release program, the programs in other states, including California, New York, and Ohio, serve certain individuals under forensic commitment who otherwise would be served in an inpatient setting. For example, the California Department of Mental Health has operated a conditional release program since 1986 as a cost-effective alternative to inpatient treatment. Conditional release patients in California receive intensive treatment in the community at approximately one-fifth the cost of placement in a state hospital.

Conditional release programs serve individuals who have been long-term patients at SMHFs and who often remain hospitalized beyond the point of their having received maximum benefit. Patients participating in a conditional release program have access to a full range of community-based services and their treatment plan includes strategies designed to manage the risk of violence. To protect the safety of the larger community, patient specific conditions of release are established. Conditions of release include minimum treatment and supervision requirements. Violations of a conditional release plan result in the revocation of the conditional release and return of the individual to a SMHF for further evaluation and treatment.

In December 2011, the DSHS Forensic Services Committee, comprised of SMHF staff, proposed to pilot a conditional release program at no additional cost to the state. As of December 2012, the pilot had not yet been implemented by DSHS. The purpose of the proposed pilot is to demonstrate the efficacy of conditional release programming in reducing unnecessary use of inpatient resources. The pilot program would most likely operate under existing statutory provisions related to furloughs and outpatient commitments. An LMHA could serve as the community-based service provider and patients could be selected from one or more SMHFs. The program could target existing adult patients at SMHFs and community mental health hospitals found not guilty by reason insanity and defendants found incompetent to stand trial who are on extended commitments (i.e., at an inpatient setting for longer than one year), are unlikely to regain competency, and for whom the courts have not dismissed the charges or the commitment. According to the DSHS Forensic Services Committee, essential components of a conditional release pilot program include, but are not limited to:

- Patients must meet all eligibility requirements to participate in a conditional release program including, documented evidence of medication compliance, no recent incidences of restraint and seclusion, no emergency medication, have at least two stable or declining in severity assessments, and have the capacity to reliably participate in recommended outpatient psychiatric treatment.
- A risk assessment—the DSHS Psychiatric Security Review—would be used to identify clients who could be safely served in the community.
- Release would be contingent on the patient's written agreement to follow a treatment plan designed jointly by the patient, inpatient treatment team, LMHA care coordinator, and approved by the committing court. The treatment plan would include strategies designed to manage the risk of violence.
- Patients would have direct access to a full range of community-based services including, individual and group therapies, supported housing, collateral contacts, home visits, substance abuse screenings, psychological assessments, medication, and case management, as appropriate.

- Patients would have opportunities for participation in community based vocational programming, supported work programs, or a job.
- Patients must abstain from alcohol and drugs with corresponding lab screening.
- Conditions of release would set minimum treatment and supervision requirements and violation of any such condition would result in an expedient return of the patient to inpatient status by the court.
- Failure to comply with established conditions for release would be viewed as a treatment failure and would be addressed clinically.
- Participating SMHFs would work with the participating LMHA to facilitate the release of eligible patients to the program and would readmit patients who fail to comply with the conditional release plan within 24 hours of notification by the LMHA.
- The participating LMHA would immediately appeal to the court for a change in commitment status from outpatient to inpatient when conditions of release are violated. Participating SMHFs would revoke the furlough status of conditional release patients who violate conditions of release.
- The participating LMHA would submit quarterly reports on patient progress to participating SMHFs and the committing court.

REDUCE FORENSIC CASES IN THE STATE MENTAL HEALTH HOSPITAL SYSTEM

The state mental health hospital system in Texas does not have the capacity to meet current demand for services. As a result, some individuals committed to a mental health facility because they are IST or NGRI have historically been placed on a waiting list maintained by DSHS while they wait to be admitted to the state mental health hospital system. Some individuals under civil commitment may also be unable to access care at a SMHF in a timely manner. Statute does not provide explicit authority for the operation of jail-based competency restoration or conditional release programming that is less expensive than treatment in the state mental health hospital system. Also, the state may not be maximizing its use of existing outpatient competency restoration programs and residential rehabilitation units. As a result, access to and use of less-expensive alternative settings, which could help reduce demand for inpatient treatment in Texas, is limited.

Serving certain individuals under forensic commitment in alternative settings instead of the state mental health hospital system could result in cost avoidance for the state. **Figure 14** shows the average annual cost per case for forensic commitments by treatment setting in fiscal year 2012. As shown in **Figure 15**, the estimated annual maximum cost that could be avoided by serving IST cases in jail-based restoration instead of a SMHF is $19.4 million in All Funds. The estimated annual maximum cost that could be avoided by serving certain IST cases in an OCR program instead of a SMHF is $12.7 million in All Funds. These cost avoidance estimates illustrate how each alternative could independently reduce costs for IST cases. However, increasing access to and use of both alternatives simultaneously would result in a

FIGURE 14
AVERAGE ANNUAL COST PER CASE FOR FORENSIC COMMITMENTS BY TREATMENT SETTING
FISCAL YEAR 2012

	AVERAGE ANNUAL COST PER CASE	
	INCOMPETENT TO STAND TRIAL	NOT GUILTY BY REASON OF INSANITY
State Mental Health Facility	$50,520	$95,567
Outpatient Competency Restoration	$11,894	Not applicable
Jail-Based Competency Restoration	$20,930[1]	Not applicable
Residential Rehabilitation Units	$31,298	$31,298
Conditional Release	Data not available[2]	Data not available[2]

[1]Cost figure is an estimate based on jail-based competency restoration program operating in California.
[2]Although cost estimates are not available for a conditional release program in Texas, the California Department of Mental Health reports that its conditional release patients receive intensive treatment in the community at approximately one-fifth the cost of placement in a state hospital.
Source: Legislative Budget Board.

FIGURE 15
ESTIMATED ANNUAL MAXIMUM COST AVOIDED BY SERVING IST CASES IN ALTERNATIVE SETTINGS, FISCAL YEAR 2012

	JAIL-BASED COMPETENCY RESTORATION	OUTPATIENT COMPETENCY RESTORATION
Estimated number of incompetent to stand trial (IST) cases who entered a state mental health facility (SMHF) during the given fiscal year that could have been served in alternative setting	1,840[1]	534[2]
Amount spent treating IST cases in SMHFs that could have been served in alternative setting	$67.0 million	$16.9 million
Estimated cost of treating IST cases diverted from SMHFs in alternative setting	$47.6 million	$4.2 million
Estimated Cost that Could be Avoided	**$19.4 million**	**$12.7 million**

[1]The estimated number of IST cases who could have received jail-based competency restoration includes all IST cases admitted to a SMHF during fiscal year 2012.
[2]The estimated number of IST cases who could have received outpatient competency restoration includes all IST cases admitted to a SMHF during fiscal year 2012, charged with a qualifying offense, not identified as a risk to others during both initial intake and reassessment, and not identified as a moderate or high risk to themselves during both initial intake and reassessment.
Source: Legislative Budget Board.

different cost avoidance estimate than either of the cost figures reported in **Figure 15**. These cost avoidance estimates were determined by subtracting the cost of serving certain IST cases in alternative settings from the cost of treating these cases in SMHFs. If the cost of serving certain IST cases in community mental health hospitals were included, the estimated cost avoided could be greater. Similarly, if the cost of serving certain NGRI and IST cases in either residential rehabilitation units or in a conditional release program instead of SMHFs were included, the estimated cost avoided could be greater. Due to data limitations, these cost avoidance estimates are not included.

In an effort to avoid some of the costs associated with treating individuals under forensic commitment in the state mental health hospital system, the state should take the following steps to increase access to and use of alternatives to inpatient treatment: (1) Allow individuals found incompetent to stand trial to receive jail-based competency restoration; (2) Allow certain individuals under forensic commitment to participate in conditional release; (3) Allow DSHS to use existing funds to pay for jail-based competency restoration and conditional release; and (4) Educate judges, prosecuting attorneys, and criminal defense attorneys on alternatives to inpatient treatment.

Recommendation 1 would provide access to jail-based competency restoration for individuals found incompetent to stand trial by amending the Texas Health and Safety Code to authorize DSHS to partner with counties to establish jail-based competency restoration programs that do not result in an increase in overall spending on state-funded mental health treatment. DSHS must ensure that any state funds spent on jail-based competency restoration are offset by reductions in other state-funded mental health treatment. Furthermore, DSHS would be required in statute to implement a quality review process for state-sponsored jail-based competency restoration programs whereby the programs must meet established criteria to ensure they provide high quality mental health treatment comparable to the quality of treatment that would otherwise be provided in an inpatient setting.

Recommendation 1 would also amend the Texas Code of Criminal Procedure to authorize the courts to order IST defendants to receive state-sponsored jail-based competency restoration. Currently, the Texas Code of Criminal Procedure provides only two options for IST defendants: (1) the court shall commit the defendant to a mental health facility or residential care facility; or (2) the court shall release the defendant on bail and order their participation in an outpatient treatment program with the specific objective of attaining competency to stand trial. This recommendation would provide an additional treatment option within the larger continuum of mental health treatment for IST defendants. Sections of the Texas Health and Safety Code may also require conforming amendments.

Recommendation 2 would provide access to conditional release for certain individuals under forensic commitment by amending the Texas Health and Safety Code to require DSHS to implement a conditional release pilot program based on successful models in other states, evaluate the cost-effectiveness of the pilot, submit a report on the evaluation findings to the Legislative Budget Board and the Office of the Governor by December 1, 2014, and expand the program to additional sites only if the program is effective and does

not result in an increase in overall spending on state-funded mental health treatment. Recommendation 2 would also amend the Texas Code of Criminal Procedure to authorize the courts to order individuals under forensic commitment to participate in a state-sponsored conditional release program.

Recommendation 3 would include a contingency rider in the introduced 2014–15 General Appropriations Bill to authorize DSHS to use funds appropriated for hospital facilities and services for: (1) jail-based competency restoration for individuals found incompetent to stand trial; and (2) conditional release programs for certain individuals under forensic commitment.

In Texas, the Court of Criminal Appeals (CCA) administers judicial education. Specifically, Texas Government Code, Chapter 56, establishes the judicial and court personnel training fund administered by CCA and authorizes that court to adopt rules for programs relating to education and training for attorneys, judges, justices of the peace, district clerks, county clerks, law enforcement officers, law students, and court personnel. CCA has adopted Rules of Judicial Education to govern their judicial and court personnel training program. The Rules of Judicial Education include education requirements for appellate, district, and county-level court judges that may have some involvement with forensic cases. The State Bar of Texas establishes the minimum continuing legal education requirements for attorneys. As a result, the Rules of Judicial Education do not include education requirements for prosecuting attorneys and criminal defense attorneys. However, CCA does provide some training to attorneys through its judicial and court personnel training program. Furthermore, Texas Government Code, Chapters 22 and 41, mandate that certain judges and attorneys receive training on specific topics and that the Texas Supreme Court or CCA provide for the required training. **Figure 16** lists the specific training topics required in statute.

Neither the Rules of Judicial Education nor the judicial education requirements mandated in statute require that judges receive education on alternatives to inpatient treatment that may be appropriate for certain individuals

FIGURE 16
STATUTORILY MANDATED JUDICIAL EDUCATION, FISCAL YEAR 2012

STATUTE	ENTITY	TRAINING REQUIREMENT
Texas Government Code, Section 22.012	District court judges and attorneys representing the state in the prosecution of felonies	Complete an instruction course related to the diversion of offenders from confinement in the Texas Department of Criminal Justice each year. The course must include information on case law, statutory law, and procedural rules relating to felony diversions and available community and state resources for diversions. The Supreme Court of Texas shall adopt rules to provide for the required training.
Texas Government Code, Section 22.013	Judges involved in guardianship cases	The Supreme Court of Texas shall adopt rules necessary to provide an instruction course that relates to issues that arise in guardianship cases.
Texas Government Code, Section 22.110	District, statutory county, and certain associate judges and judicial officers who hear cases involving family violence, sexual assault, or child abuse and neglect	Complete at least 12 hours of training related to the problems of family violence, sexual assault, and child abuse and neglect within the judge's first term of office or the judicial officer's first four years of service and an additional five hours of training during each additional term in office or four years of service. The Court of Criminal Appeals shall adopt rules to provide for the required training.
Texas Government Code, Section 22.1105	Judges with jurisdiction to hear complaints against children alleging violations of misdemeanor offenses punishable by fine only	Complete at least 2 hours of training related to understanding relevant issues of child welfare and the Individuals with Disabilities Education Act every judicial academic year that ends in 0 or 5. The Court of Criminal Appeals shall adopt rules to provide for the required training.
Texas Government Code, Section 22.111	Prosecuting attorneys	The Court of Criminal Appeals shall provide training related to use of certain statutes for enhancing punishment on a finding that an offense was committed because of a defendant's bias or prejudice.
Texas Government Code, Section 41.110	Prosecuting attorneys	The Court of Criminal Appeals shall adopt rules regarding training related to cases involving charges that a person committed an act of family violence.

Source: Legislative Budget Board.

under forensic commitment. CCA has held special seminars on mental health and substance abuse issues. However, judges, prosecuting attorneys, and criminal defense attorneys do not regularly receive education on alternatives to inpatient treatment that may be appropriate for certain individuals under forensic commitment. As a result, judges and other professionals involved with forensic commitment cases may be unaware of alternatives to inpatient treatment that could result in cost avoidance for the state, or of the effectiveness of these alternatives. Recommendation 4 would include a rider in the introduced 2014–15 General Appropriations Bill to authorize CCA to use funds appropriated for judicial education to educate judges, prosecuting attorneys, and criminal defense attorneys involved with forensic commitment cases on alternatives to inpatient treatment. CCA should take steps to make judges, prosecuting attorneys, and criminal defense attorneys involved with forensic commitment cases aware of these educational opportunities.

FISCAL IMPACT OF THE RECOMMENDATIONS

The recommendations in this report direct DSHS and CCA to take steps to increase access to and use of alternatives to inpatient treatment for individuals under forensic commitment. It is estimated that the recommendations would have no significant fiscal impact because they could be implemented using existing agency resources. To the extent that the recommendations in this report reduce the use of inpatient services for individuals under forensic commitment, the state could avoid some of the costs associated with treating these individuals in the state mental health hospital system.

Recommendation 1 would provide access to jail-based competency restoration for IST defendants by authorizing DSHS to partner with counties to establish jail-based competency restoration programs that do not result in an increase in overall spending on state-funded mental health treatment. DSHS would be required to implement a quality review process for state-sponsored jail-based competency restoration programs. The courts would be authorized to order IST defendants to receive state-sponsored jail-based competency restoration.

The recommendation is intended to provide access to jail-based competency restoration as a less expensive alternative for certain individuals under forensic commitment. As shown in **Figure 17**, based on savings outcomes reported for the jail-based competency restoration program operating in California, Texas should be able to reduce the average annual amount spent per IST defendant by $29,590, or 58.6 percent, for IST defendants who receive jail-based competency restoration in lieu of treatment in a SMHF. The reduction could be achieved because the daily amount the state would pay per IST defendant for jail-based restoration (i.e., $299) is lower than the daily amount the state pays per IST defendant for competency restoration in a SMHF (i.e., $421) and the average length of treatment is shorter in the jail-based program.

FIGURE 17
ESTIMATED ANNUAL POTENTIAL PER CASE COST AVOIDED BY SERVING FORENSIC CASES IN A JAIL-BASED COMPETENCY RESTORATION PROGRAM
FISCAL YEAR 2012

PROGRAM	AVERAGE DAILY COST	AVERAGE NUMBER OF DAYS PER CASE	AVERAGE ANNUAL COST PER CASE
State Mental Health Facility	$421	120	$50,520
Jail-Based Competency Restoration	$299	70	$20,930
Potential Cost and Days Avoided	$122	50	$29,590

Source: Legislative Budget Board.

Establishing jail-based competency restoration may require an initial outlay of funds. However, DSHS must ensure that any state funds spent on jail-based competency restoration are offset by reductions in other state-funded mental health treatment.

Recommendation 2 would provide access to conditional release programming for certain individuals under forensic commitment by requiring DSHS to implement a conditional release pilot program, evaluate the cost-effectiveness of the pilot, submit a report on the evaluation findings to the Legislative Budget Board and the Office of the Governor, and expand the program to additional sites only if the program is effective and does not result in an increase in overall spending on state-funded mental health treatment. The courts would be authorized to order individuals under forensic commitment to participate in a state-sponsored conditional release program.

The recommendation is intended to provide access to conditional release programming as a less expensive alternative for certain individuals under forensic commitment. The proposal submitted by the DSHS Forensic

Services Committee was for DSHS to implement the pilot at no additional cost to the state because the participating LMHA would use existing resources to provide community-based services. The evaluation of the pilot could be implemented using existing agency resources. DSHS is directed to expand the program to additional sites only if the program is effective and does not result in an increase in overall spending on state-funded mental health treatment. DSHS must ensure that any state funds spent on conditional release programming are offset by reductions in other state-funded mental health treatment.

Recommendation 3 authorizes DSHS to use funds appropriated for hospital facilities and services for: (1) jail-based competency restoration for individuals found incompetent to stand trial; and (2) conditional release programs for certain individuals under forensic commitment. This recommendation could be implemented using existing agency resources.

Recommendation 4 authorizes CCA to use funds appropriated for judicial education to educate judges, prosecuting attorneys and criminal defense attorneys involved with forensic commitment cases on alternatives to inpatient treatment. This recommendation could be implemented using existing agency resources.

The introduced 2014–15 General Appropriations Bill includes riders to implement Recommendations 3 and 4.

MAXIMIZE THE USE OF PRIVATE HEALTH INSURANCE COVERAGE FOR CERTAIN CLIENTS SERVED BY THE DEPARTMENT OF STATE HEALTH SERVICES

The federal Affordable Care Act of 2010 requires states to have an operational health insurance exchange in place by January 1, 2014. Health insurance exchanges are intended to facilitate the purchase of health insurance coverage for individuals and small businesses. Individuals with household incomes between 100 percent and 400 percent of the federal poverty level who do not have access to employer-sponsored insurance or public coverage will be eligible for premium assistance credits to help pay for health insurance purchased through the new health insurance exchange. These individuals will also be eligible for reduced cost-sharing in the exchange plans.

The Texas Department of State Health Services anticipates that beginning in fiscal year 2015, 18 of the agency's programs could be affected by the creation of a health insurance exchange. The health insurance exchange is projected to expand insurance coverage for many individuals and impact close to 44,000 clients served by programs at the Department of State Health Services. In fiscal year 2015, the agency estimates that the health insurance exchange will result in a net positive fiscal impact of $11.6 million in All Funds.

As clients currently served by programs at the Texas Department of State Health Service obtain greater access to health insurance coverage through the exchange, the agency should ensure ways to maximize the use of private health insurance for these clients. Additionally, the agency should monitor the caseload and fiscal impacts of the health insurance exchange on agency clients and programs.

CONCERNS

- ♦ The Department of State Health Services projects that the health insurance exchange could result in a net positive fiscal impact of $11.6 million in All Funds in fiscal year 2015. However, the agency does not account for any savings or revenue gains in fiscal year 2014 because it assumes that the exchange will not be operational in fiscal year 2014. Also, the agency does not account for the projected fiscal impact of the health insurance exchange in the agency's base request for the 2014–15 biennium.
- ♦ There is no requirement for the Texas Department of State Health Services to report to the Legislature on the impact of the health insurance exchange on agency programs, which will be essential for making informed policy and funding decisions.
- ♦ The Texas Department of State Health Services lacks a standardized and documented process to determine whether clients receiving services through the agency's programs could have access to private health insurance coverage that may provide similar services. Additionally, the agency lacks a mechanism to increase awareness amongst eligible clients about the health insurance exchange. As a result, the agency risks not maximizing alternative sources of coverage for clients and reducing state expenditures.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Reduce appropriations to realize net savings and revenue gains of $14.4 million in the 2014–15 biennium for agency strategies that are projected to have reduced costs due to the health insurance exchange.
- ♦ **Recommendation 2:** Include a rider in the introduced 2014–15 General Appropriations Bill requiring the Texas Department of State Health Services to notify the Legislative Budget Board if savings and revenue gains related to the implementation of a health insurance exchange are lower than projected. This notification would occur at least 30 days prior to a projected deficit in funds. The rider would also require the agency to obtain written approval from the Legislative Budget Board and the Office of the Governor prior to expending any additional General Revenue Funds if actual savings and revenue gains related to the health insurance exchange are greater than projected.
- ♦ **Recommendation 3:** Include a rider in the introduced 2014–15 General Appropriations Bill requiring the Texas Department of State Health Services to report on caseload impact, consumer awareness outcomes and the fiscal impact of the exchange on the agency's programs. The agency should submit a report to

the Legislative Budget Board and the Office of the Governor by December 1, 2014.

- ♦ **Recommendation 4:** Amend statute to require the Texas Department of State Health Services to distribute and collect attestation forms from clients of programs anticipated to be impacted by the health insurance exchange. Clients would have to attest that they do not have access to other sources of healthcare coverage. Programs should also advise clients with incomes above 100 percent of the federal poverty level about the health insurance exchange and subsidies available through the exchange.

DISCUSSION

The federal Affordable Care Act of 2010 (ACA) requires that every state have an operational health insurance exchange (HIX) by January 1, 2014. The HIX was included in the ACA as a means to increase access to health insurance.

A HIX is a structured, virtual, marketplace where individuals and small businesses looking to purchase health insurance will be able to compare and select from multiple options of health insurance coverage. Health insurance companies will be able to sell health insurance plans through the HIX if they meet a number of standards outlined in the ACA. Insurers participating in the HIX will be required to offer various tiers of coverage. **Figure 1** shows the specified tiers of coverage to be offered in the HIX. Qualified health insurers must offer at least one plan at the Silver level and one plan at the Gold level in each HIX in which their plans are offered.

FIGURE 1
TIERS OF COVERAGE IN THE HEALTH INSURANCE EXCHANGE, 2014

PLAN TYPE	COVERAGE LEVEL
Bronze	Plan covers benefits equivalent to 60 percent of the full actuarial value of plan benefits
Silver	Plan covers benefits equivalent to 70 percent of the full actuarial value of plan benefits
Gold	Plan covers benefits equivalent to 80 percent of the full actuarial value of plan benefits
Platinum	Plan covers benefits equivalent to 90 percent of the full actuarial value of plan benefits
Catastrophic	Plan for individuals younger than age 30 and people who are exempt from the individual responsibility requirements

Source: Kaiser Family Foundation.

In operating a HIX, states have the option to: (1) build a fully state-based HIX; (2) enter into a state-federal partnership exchange; or (3) default into a federally facilitated exchange. States planning to operate a state-facilitated HIX were required to submit a letter to the federal Department of Health and Human Services (HHS) by November 16, 2012, declaring their intention to establish their own HIX. These states were required to submit exchange planning documents to HHS by December 14, 2012.

In December 2012, Texas was one of 25 states that opted not to establish a state HIX. For states like Texas that default into a federally facilitated HIX, the HHS Secretary will have the authority to establish and operate a HIX in that state, or do so through an agreement with a non-profit entity. HHS will coordinate with states opting not to establish their own HIX on health insurance plan certification, oversight functions, consumer assistance and outreach, and streamlining eligibility determinations.

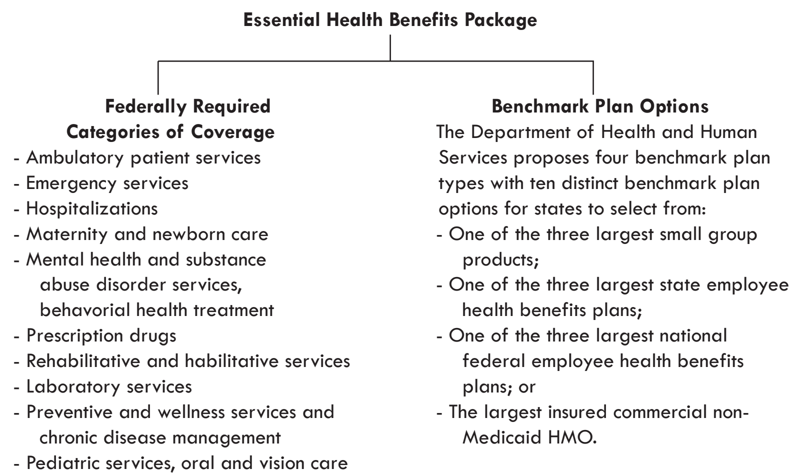
Health insurance plans offered through the HIX must be certified as "Qualified Health Plans" or QHPs. One of the requirements to be certified as a QHP is the coverage of 10 federally defined Essential Health Benefits (EHB). The ACA requires that all individual and small group health insurance plans offered in and out of the HIX cover the EHBs beginning in January 2014. **Figure 2** shows the EHBs listed under the "Federally Required Categories of Coverage." Each state will have a unique essential health benefits package, which will include the federally required EHBs, and benefits included in an existing health insurance plan selected by each state as its benchmark plan. States have the option to select from 1 of 10 existing health insurance plans in their state identified by federal law for their benchmark plan. **Figure 2** shows the 10 options of the benchmark plan.

States were required to submit their selected benchmark plan to HHS by September 30, 2012. Texas did not select a benchmark plan, so the default benchmark plan became the small group plan with the largest enrollment in the state, or the Blue Cross Blue Shield Best Choice Plan. **Figure 3** shows a list of other key HIX implementation requirements and dates.

ELIGIBILITY FOR SUBSIDIES THROUGH THE HEALTH INSURANCE EXCHANGES

HIXs will provide a marketplace for individuals shopping for private health insurance coverage. To be eligible for enrollment in a QHP through the HIX, an individual must meet the following criteria:

FIGURE 2
ESSENTIAL HEALTH BENEFITS PACKAGE
FISCAL YEAR 2012



Source: Texas Department of Insurance.

FIGURE 3
KEY HEALTH INSURANCE EXCHANGE IMPLEMENTATION DATES AND REQUIREMENTS
CALENDAR YEARS 2012 TO 2014

DATE	REQUIREMENT
September 30, 2012	States must specify a benchmark plan to serve as the reference plan for the essential health benefits for coverage years 2014 and 2015. If a state does not select a benchmark plan, the default plan is the small group with the largest enrollment in the state.
November 16, 2012	States seeking to administer a state-based exchange must submit a declaration letter to HHS no later than this date to be considered for exchange approval by January 1, 2013.
December 14, 2012	States seeking to administer a state-based exchange must submit a complete exchange blueprint application no later than this date.
January 1, 2013	Each exchange must be approved to operate by HHS no later than this date in order to be operational on January 1, 2014.
February 15, 2013	States pursuing a partnership exchange must submit a declaration letter and blueprint application no later than this date.
October 1, 2013	Open enrollment must begin for coverage offered through an exchange for the 2014 coverage year.
January 1, 2014	Exchanges must be established and offer coverage in each state.

Source: Congressional Research Service.

- 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.

Individuals with household incomes between 100 percent and 400 percent of the federal poverty level (FPL) who do not have access to employer-sponsored insurance or public insurance coverage will be eligible for premium assistance credits and reduced cost-sharing to help pay for health insurance purchased through a state or federally operated HIX. **Figure 4** shows eligibility criteria for individuals to receive premium and cost-sharing assistance.

Premium subsidies will be available as a refundable or advanceable tax credit. Refundable tax credits are available to an individual even if he or she has no tax liability. Advanceable tax credits provide individuals with assistance when they purchase insurance rather than reimbursing an individual through their annual income tax return. The amount of tax credits available to an individual will be based on the premium for the Silver plan in the HIX and the area where

FIGURE 4
KEY ELIGIBILITY CRITERIA FOR PREMIUM ASSISTANCE CREDITS AND REDUCED COST-SHARING THROUGH THE HEALTH INSURANCE EXCHANGE
2012

SUBSIDY TYPE	ELIGIBILITY REQUIREMENT
Advanced payment of premium tax credits	• Meets the criteria for eligibility for enrollment in a QHP through the Health Insurance Exchange (HIX) • Not eligible for minimum essential coverage including employer coverage or public insurance coverage such as Medicaid or Medicare • Is part of a tax-filing unit • Is enrolled in a Qualified Health Plans (QHP) offered through a HIX • Has a household income that either is: between 100% federal poverty level (FPL) and 400% FPL; or is not greater than 100% FPL and is an alien lawfully present (but not eligible for Medicaid because of duration of U.S. residency)
Cost-sharing subsides	• Meets the criteria for eligibility for enrollment in a QHP through a HIX • Meets the criteria for eligibility for advance payment of premium tax credits • Is enrolled in a Silver plan through the HIX • Has a household income between 100% and 400% FPL

Source: Congressional Research Service.

the person is eligible to purchase coverage. The tax credit amount that an individual will be eligible for will vary with his or her income adjusted for family size. The premium that a person would be required to pay would be limited to a specific percentage of his or her income. **Figure 5** shows the amount of premium tax credits available by income level.

Cost-sharing subsidies are intended to assist people with incomes between 100 percent and 400 percent FPL from having to pay high out-of-pocket costs including deductibles, copayments, and coinsurance at the point of service. Individuals with incomes between 100 percent and 250 percent FPL will be eligible for additional cost sharing reductions so that on average, plans will have to pay a greater share of covered benefits. For example, a silver plan, which would typically cover 70 percent of medical costs for covered services, would be required to cover between 73 percent and 94 percent of medical costs for individuals with income levels between 100 percent and 250 percent FPL. Additionally, individuals at or below 400 percent FPL will have their out-of-pocket liability capped at lower levels than the general population.

FIGURE 5
HEALTH INSURANCE EXCHANGE PREMIUM CREDITS BY INCOME LEVEL
2012

INCOME LEVEL (FEDERAL POVERTY LEVEL)	PREMIUM AS A PERCENTAGE OF INCOME
Up to 133%	2%
133% to 150%	3% to 4%
150% to 200%	4% to 6.3%
200% to 250%	6.3% to 8.05%
250% to 300%	8.05% to 9.5%
300% to 400%	9.5%

Source: Kaiser Family Foundation.

EFFECT OF THE HEALTH INSURANCE EXCHANGE ON THE DEPARTMENT OF STATE HEALTH SERVICES PROGRAMS

The Texas Department of State Health Services (DSHS) projects that the implementation of the HIX and access to subsidies for people with incomes between 100 percent and 400 percent FPL will affect caseloads and costs at certain programs in the agency.

Figure 6 shows 18 programs that DSHS anticipates will realize savings in General Revenue Funds and General Revenue–Dedicated Funds due to program participants' enrollment in insurance plans offered by the HIX beginning in fiscal year 2015. The agency projects that approximately 44,000 clients could enter the HIX, although more could be eligible.

DSHS identified programs that provide direct, one-on-one medical care or other types of support to clients, such as transportation assistance. Programs that were population-based, surveillance-focused, or regulatory in nature were excluded from their analysis. For example, strategies related to disease registries, epidemiology surveillance, and preparedness planning were not included in the agency's analysis.

FIGURE 6
DEPARTMENT OF STATE HEALTH SERVICES PROGRAMS AFFECTED BY THE HEALTH INSURANCE EXCHANGE
FISCAL YEAR 2015

STRATEGY	PROGRAM NAME	ANNUAL NUMBER OF CLIENTS PROJECTED TO ENTER HIX	FISCAL YEAR 2015 PROGRAM SAVINGS (GENERAL REVENUE FUNDS AND GENERAL REVENUE–DEDICATED FUNDS)
A.2.1	Immunizations	24,804	$937,477
A.2.2	HIV/STD Prevention Program	824	$326,772
A.2.3	Tuberculosis	2,320	$635,887
A.3.3	Kidney Health Care	2,060	$1,594,620
A.3.4	Children with Special Health Care Needs	40	$861,044
A.3.5	Epilepsy Services	394	$368,228
A.3.5	Hemophilia Services	1	$13,294
B.1.2	Women and Children's Breast and Cervical Cancer Services	32	$7,748
B.1.4	Primary Health Care	4,832	$978,945
B.2.1	Mental Health Adult Services	1,272	$2,214,207
B.2.2	Mental Health Children	242	$448,244
B.2.3	Mental Health Crisis Services	260	$337,181
B.2.4	NorthSTAR	1,069	$1,471,093
B.3.3	Indigent University of Texas at Medical Branch	5,526	$1,352,188
C.1.1	Texas Center for Infectious Diseases	1	$59,813
C.1.2	South Texas Health Care System	252	$5,775
C.1.3	State Hospitals	107	$1,470,106
C.2.1	Mental Health Community Hospitals	59	$852,175
Total		**44,091**	**$13,934,796**

Note: Projected clients assumes 50 percent take-up rate.
Source: Texas Department of State Health Services.

DSHS estimated the annual number of clients who could enter the HIX using the following assumptions and information:

- Client counts were based on available program data from fiscal years 2010 or 2011.
- Client counts did not include non-citizens. The number of clients assumed to be citizens was estimated using program data or U.S. Census Bureau estimates.
- The client counts included only clients who would be eligible for subsidies within the HIX, or clients who are citizens with income levels between 133 percent and 400 percent of the FPL.
- Client counts included only clients who are not eligible for Medicaid and are therefore funded by General Revenue Funds. If these clients obtained health insurance coverage through the HIX, there could be General Revenue Fund savings to the state.
- A 50 percent "take-up" rate. A take-up rate measures the fraction of people who are eligible for a program who choose to enroll.

The total savings per program was estimated by multiplying the projected number of clients that would be impacted by the HIX by the average cost per client. The average cost per client was estimated using the following assumptions:

- Cost estimates included only costs of services assumed covered by private insurance. DSHS noted that there are limitations to these cost estimates because private health insurance plans vary in the amount, duration, and scope of services covered. For example, DSHS may cover unlimited case management services but a private insurance plan may cover up to three visits.

- The average cost per client amounts were adjusted to provide funding needed to meet maintenance of effort (MOE) requirements for select federal grants, such as the Ryan White funding for HIV/AIDS program. MOE refers to a minimal level of state spending required as a condition of receiving Federal Funds.

The federal Congressional Budget Office (CBO) estimates that in 2014 there will be 9 million non-elderly enrollees in HIXs across the nation. Following the U.S. Supreme Court's decision to make Medicaid expansion optional for states, the CBO expects fewer people to obtain coverage from Medicaid or the Children's Health Insurance Program (CHIP) than originally estimated in 2010, and more people to obtain coverage through HIXs or to be uninsured.

The Seventy-sixth Legislature, 1999, passed legislation establishing a separate CHIP program to provide subsidized health insurance for families with children who had incomes below 200 percent of the FPL. Program implementation was scheduled for May 1, 2000. In fiscal year 2000, the year the program was launched, the average monthly caseload for the CHIP population was 28,300.

Although DSHS estimates that there could be savings related to the HIX in fiscal year 2015, the agency did not build these savings into their baseline request. Furthermore, DSHS did not account for any fiscal impact related to the HIX in fiscal year 2014 because the agency assumes that the federal government will not have an operational HIX in the state until fiscal year 2015. However, Texas' experience with the CHIP program shows that it is plausible that individuals will enroll in the HIX during the first year of implementation.

The agency should account for savings and revenue gains related to the HIX in fiscal year 2014 and 2015. Recommendation 1 would reduce DSHS's appropriated amounts by a net of $2.8 million in All Funds in fiscal year 2014 and a net of $11.6 million in All Funds in fiscal year 2015 for select agency strategies that are projected to be affected by the HIX. Savings and revenue gain estimates in fiscal year 2014 were derived using the same assumptions that DSHS used for fiscal year 2015. It was assumed that the agency would be impacted by the HIX in June, July, and August, or for 3 months in fiscal year 2014 to account for the estimated time necessary to initiate the HIX. The agency anticipates that DSHS will experience a revenue gain in Other Funds as a result of payments from insurance companies for services provided by the agency, such as at the state hospitals.

Recommendation 2 would include a rider in the introduced 2014–15 General Appropriations Bill requiring DSHS to notify the Legislative Budget Board in the event that savings and revenue gains related to the implementation of a HIX are lower than projected. The agency would be required to notify the Legislative Budget Board at least 30 days prior to a projected deficit in funds. The rider would also require the agency to obtain written approval from the Legislative Budget Board and the Office of the Governor prior to expending any additional General Revenue Funds if actual savings and revenue gains related to the health insurance exchange are greater than projected.

It will be essential for DSHS to monitor the impact of the HIX on programs at DSHS. There is currently no requirement to ensure that the agency monitor and report on the impact of the HIX on DSHS programs to the Legislature, which will be important for making informed policy and funding decisions. To ensure that ongoing monitoring of the impact of the HIX occurs, Recommendation 3 would include a rider in the introduced 2014–15 General Appropriations Bill requiring DSHS to report on program caseload impact, consumer awareness outcomes and the fiscal impact of the HIX on programs at DSHS.

MAXIMIZING ALTERNATIVE SOURCES OF COVERAGE FOR DSHS CLIENTS

Any services individuals receive through private health insurance coverage provided by the HIX could reduce the cost of providing care at DSHS programs. When clients present themselves for services at one of the agency's programs listed in **Figure 6**, each program or the program's contractor collects certain client information to determine eligibility for services. Client information collected can include:

- medical condition or diagnosis;
- income level;
- age;
- gender; and
- residency status.

The type of client information that the program collects depends on each program's eligibility requirements. For example, eight of the programs have income requirements and therefore collect this information, while programs that do not have income requirements do not collect this data.

Programs also have varying policies and practices related to determining whether a client has access to public or private insurance. All 18 programs verify a client's eligibility or enrollment in Medicaid using the Texas Integrated Eligibility Redesign System or other sources. Only two of the programs do not have a policy in place to bill public insurance for services that Medicaid could cover.

Fourteen of the programs reported that they verify private insurance coverage by the use of client reported data. Nine of the programs noted that they have a policy in place to bill private insurance plans for services that could be covered by private insurance plans.

Access to private insurance coverage is projected to increase with the implementation of the ACA's HIX in 2014. While there is consistency across programs in verifying a client's eligibility or enrollment in Medicaid, program practices vary regarding the verification of private insurance coverage. The Early Childhood Intervention Program, administered by the Department of Assistive and Rehabilitative Services, requires families to provide written attestation related to third-party coverage and other client information. The attestation form requires that families provide true and accurate information about alternative coverage and states that the misrepresentation or withholding of information could subject a client to criminal and civil penalties or the denial of services.

As the HIX is implemented, it will be important for programs and their contractors to increase eligible clients' awareness of the HIX and subsidies within the HIX. Certain individuals with incomes between 100 percent and 400 percent FPL could benefit the most from the HIX due to their eligibility for subsidies to purchase private insurance coverage through the HIX.

Recommendation 4 would amend state statute to require DSHS to distribute and collect attestation forms from clients of programs anticipated to be impacted by the health insurance exchange. Clients would have to attest that they do not have access to other sources of healthcare coverage. Additionally, Recommendation 4 would require programs to advise clients with incomes over 100 percent FPL about subsidies and coverage opportunities through the HIX. Program staff or contractors could provide appropriate clients with information on the HIX and contact numbers for the HIX administrator. This information could be provided in the form of a pamphlet or hand-out.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendation 1 reduces appropriated amounts to reflect program savings and revenue gains in the 18 programs that are projected to be impacted by the HIX. This reduction would result in a net positive fiscal impact of $14.4 million in All Funds for the 2014–15 biennium. **Figure 7** shows the five-year fiscal impact of the HIX on programs at DSHS as projected by the agency.

General Revenue Funds and General Revenue–Dedicated Funds savings shown in **Figure 7** include amounts realized from the revenue gain in Other Funds. As a result, the net fiscal impact for fiscal year 2014 is $2.8 million in All Funds and for fiscal year 2015, $11.6 million in All Funds.

Recommendations 2, 3 and 4 can be implemented with existing agency and state resources and would have no significant fiscal impact.

The introduced 2014–15 General Appropriations Bill includes a reduction in appropriated amounts to reflect Recommendation 1, and a rider to implement Recommendations 2 and 3.

FIGURE 7
FIVE-YEAR FISCAL IMPACT OF THE HEALTH INSURANCE EXCHANGE AT DSHS, FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE FUNDS	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE–DEDICATED FUNDS	PROBABLE REVENUE GAIN/(LOSS) IN OTHER FUNDS
2014	$3,139,217	$262,790	$585,294
2015	$12,883,638	$1,051,159	$2,341,178
2016	$12,883,638	$1,051,159	$2,341,178
2017	$12,883,638	$1,051,159	$2,341,178
2018	$12,883,638	$1,051,159	$2,341,178

SOURCE: Legislative Budget Board.

ENSURE SUFFICIENT OVERSIGHT OF THE FOSTER CARE REDESIGN

Redesigning the Texas foster care system is underway. The Texas Department of Family and Protective Services is directed via Senate Bill 218, Eighty-second Legislature, Regular Session, 2011, to implement a redesign of the foster care system in accordance with the department's 2010 recommendations to the Legislature. In the new system, the department will contract with one private entity to provide a full continuum of foster care services in one region of the state. Additionally, according to the legislation, the system must include a payment system based on performance targets. The payment rates may not result in total expenditures for any fiscal year during the 2012–13 biennium that exceed the amounts appropriated by the Eighty-second Legislature for foster care and other purchased services, except for normal entitlement caseload growth.

Privatizing more child welfare services does not relieve the state of its responsibilities to ensure that children and families are adequately served and public funds are spent appropriately; however, the state's role is altered. In the newly redesigned system, the state's primary role is one of oversight. Monitoring foster care services provided by private contractors will be critical given the vulnerable population served and the provider failures that have occurred with this model in other states. Contracting with a lead agency to provide foster care services without statutory safeguards to ensure the continuity of services if a lead agency fails, increases the risk for service delivery interruptions, cost overruns, and harm to children and families. Establishing a comprehensive and coordinated system of oversight is essential to ensure improved client outcomes, continuity and quality of foster care services, adherence to state and federal requirements, and accountability and transparency in the use of public funds.

FACTS AND FINDINGS

- ♦ The State of Texas' redesigned foster care system will use a lead agency model. A lead agency may be a single non-governmental entity or composed of multiple non-governmental entities that joined together through collaboration for the purposes of responding to a contract opportunity.
- ♦ Through the lead agency model, the Department of Family and Protective Services will contract with a single lead non-governmental agency, also referred to as the Single Source Continuum Contractor, to provide a full continuum of foster care services in the designated catchment area. The lead agency may either provide all the services directly or establish a network of providers to work as sub-contractors to ensure the needed services are available.
- ♦ One contract to implement the redesigned system has been tentatively awarded to Providence Service Corporation of Texas in the non-metropolitan catchment area (Region 2/9 – Abilene, Wichita Falls, Midland, and San Angelo).
- ♦ The Department of Family and Protective Services is directed through Rider 25 in the 2012–13 General Appropriations Act to report to the Texas Legislature and the Office of the Governor regarding the expenditures for foster care redesign and the progress toward the achievement of improved outcomes for children, youth, and families based on quality indicators identified in the department's Foster Care Redesign report.

CONCERNS

- ♦ Monitoring foster care services provided by private contractors will be critical given the vulnerable population served and the provider failures that have occurred with this model in other states. The Department of Family and Protective Services is not required to establish an early warning system that will monitor factors impacting a lead agency's financial viability.
- ♦ Contracting with a lead agency to provide foster care services without statutory safeguards to ensure the continuity of services if a lead agency fails, increases the risk for service delivery interruptions, cost overruns, and harm to children and families. Allowing the lead agency to provide all services needed in a region could reduce the number of other providers in the region.
- ♦ Using a single lead agency to provide foster care services further removes the state from direct interaction with a vulnerable client population and increases the need for timely, independent monitoring to prevent gaps

in accountability and transparency from occurring. The State Auditor's Office is authorized to conduct annual audits of residential foster care providers, but no outside entity is statutorily directed to audit the lead agency.

- According to an April 2010 Department of Family and Protective Services' internal audit report, 25 percent of the agency's contract management and oversight staff that performed fiscal monitoring activities did not feel they had sufficient training or knowledge to perform them or review the work of others who performed these activities. Thirty percent were "unsatisfied" or "very unsatisfied" with the quantity and quality of the training provided by the agency. A lack of sufficient training weakens the contract oversight structure because contract management staff is the primary resource used to ensure contract compliance occurs and to provide timely, initial warning of emerging or imminent problems.
- The Department of Family and Protective Services is not required to report performance measures that would allow for comparison between the legacy foster care system and the redesigned system, which prohibits any analysis to determine whether the redesigned system's goals are being met and improvement is occurring.
- The Department of Family and Protective Services has not established a process to determine a lead agency's operational readiness to accept the transfer of certain foster care services from the state which may result in problems including the disruption of services to children and families that could have been identified and prevented.
- Every state that has implemented statewide privatized foster care services has experienced the failure of a lead agency resulting in the disruption of services and increased expenditures to replace the failed provider. The Department of Family and Protective Services lacks sufficiently detailed intervention and contingency plans to implement in the event of a financial emergency, or problems with a lead agency's performance or service quality.
- Without timely and accurate information regarding the provision of court-ordered services, judges presiding over child protective services cases cannot assess a child's progress and make meaningful recommendations about how permanency for the child can be achieved.

RECOMMENDATIONS

- **Recommendation 1:** Amend statue to require the Department of Family and Protective Services to incorporate into its current contract monitoring activities, a system or process that would collect and monitor data and information that could be used for the early identification of lead agency problems and the evaluation of lead agency viability, and to report annually to the Legislative Budget Board and the Office of the Governor on the lead agencies' performance and viability.
- **Recommendation 2:** Amend statute to limit the direct provision of services provided by a single lead agency in its specified geographic area so that it may not exceed 35 percent of total expended amounts of the contract.
- **Recommendation 3:** Amend statute to require the Health and Human Services Commission to contract with the State Auditor's Office to conduct fiscal and programmatic audits of a lead agency contracting with the Department of Family and Protective Services to provide foster care services in certain geographic areas of the state, as necessary.
- **Recommendation 4:** Include a rider in the introduced 2014–15 General Appropriations Bill to require the Department of Family and Protective Services to provide contract management staff with sufficient on-going training to ensure their ability to perform fiscal and financial analysis and oversight of the lead agencies' contracts.
- **Recommendation 5:** Include a rider in the introduced 2014–15 General Appropriations Bill to require the Department of Family and Protective Services to report performance measures that compare outcomes from the legacy and redesigned systems.
- **Recommendation 6:** Amend statute to require the Department of Family and Protective Services to develop, with input from lead agencies, a process and an assessment tool to determine a lead agency's ability to accept the responsibility of providing certain foster care services before services are transferred from the state to the lead agency.

- ♦ **Recommendation 7:** Amend statute to require the Department of Family and Protective Services to develop a progressive intervention plan and contingency plan for the continuity of foster care service delivery in certain geographic areas.
- ♦ **Recommendation 8:** Amend statute to require guardians ad litem to notify the court before the next scheduled court hearing if court-ordered services are not delivered to the child/family in a reasonable time frame.

DISCUSSION

In the U.S., more than 400,000 children were in foster care in 2010, according to the U.S. Department of Health and Human Services (HHS). In fiscal year 2011, 17,108 Texas children were removed from their homes because it was unsafe for them to remain there. Nearly all of them entered foster care or other substitute care to receive services so that they could be reunified with their family or find a permanent home with a foster or adoptive family or permanent guardian. Foster care is meant to be a temporary placement for children who are unable to live safely in their homes. Since the 1880s, private entities have been providing services to assist families by offering and maintaining safe environments for children. Since that time, government entities have worked together with mostly non-profit child welfare agencies, faith-based charities, and other groups to provide resources to troubled families and children. Contracting with private entities to provide child welfare services is a form of privatization. Since the 1990s, most states have relied on the private sector to provide social services, such as foster care, to help manage reduced public resources.

One of the most common forms of privatization is contracting or outsourcing for a service to be provided to a population. In this form, the government provides funding to the private entity to provide the service while the government maintains control through contractual language regarding the type and quality of service to be provided. Using private entities to provide foster care services does not relieve the state of being ultimately responsible for the welfare of children and families it previously served directly. Nor does it relieve the state of the responsibility of ensuring public funds are spent efficiently for quality services that meet state and federal regulations. However, the increased use of privatized foster care services alters the state's role. Its role as a provider diminishes and its role as a monitor increases.

A reliance on private contractors to deliver services increases concern about whether state governments' monitoring of contractors is adequate. In 2004, the U.S. Department of Health and Human Services Office of the Inspector General (HHS OIG) assessed six states' compliance with federal grant requirements that apply to the use and monitoring of sub-grantees or private providers. The HHS OIG found that half of the states did not implement monitoring mechanisms, did not take planned site visits, and did not adequately oversee the fiscal monitoring of private providers.

In 1997, the U.S. Government Accountability Office reported that the weakest link in the privatization process is monitoring a contractor's performance. Contract monitoring in child welfare is complex due to many reasons including the use of multiple funding sources, many state and federal requirements, and a reliance on sub-contractors to deliver direct care services which further removes the state from interacting with its client population. The contract monitoring strategies of government entities vary by the type of contract and services delivered. According to HHS, a monitoring plan should be developed for each contract. The monitoring plan identifies what the government will do to guarantee the contractor's performance meets contract requirements and standards. The plan details how the monitoring will occur and what will be monitored because different services and outcomes require different types and levels of monitoring.

CONTRACT MONITORING AND CONTINGENCY PLANNING

As the use of private providers by government entities increases, monitoring activities have evolved. Before the last 10 years, compliance monitoring was the main activity of the monitoring staff. Compliance monitoring ensures contractors are maintaining sufficient records about the delivery of services, the delivery of services are performed according to the terms of the contract, and documentation required by the contract is present. With the addition of fiscal risk and rewards linked to a provider's performance, monitoring activities now include performance monitoring to measure the ability of the contractor to meet pre-established goals and fiscal monitoring to examine the contractor's financial health and compliance with generally accepted accounting standards and practices.

Collecting monitoring information is only effective if staff who review and analyze it are effective. The HHS and states that have privatized foster care services report that contract

monitoring staff needs new skills to review data reported about a provider's performance and fiscal activities. Contract monitoring staff requires more sophisticated skills and tools beyond the basic compliance monitoring of the past. Published research indicates the need for improved training for contract monitoring staff; however, specific information about the type of training needed is not available. According to the HHS, governments looking for training opportunities should look to peer entities that have undertaken privatization efforts or national organizations for guidance. Staff turnover is a chronic problem in child welfare work and contract monitoring staff is no exception. Unaddressed turnover affects the level of expertise and institutional knowledge among contract monitoring staff which can affect the rigor and thoroughness of the monitoring. Ongoing training is suggested for contract management staff to help address staff turnover.

RESULTS FROM STATEWIDE PRIVATIZATION OF FOSTER CARE

Florida, Kansas, and Nebraska are the three states that privatized the majority of their foster care services statewide. In each case, states experienced significant obstacles transitioning from a legacy system to a fully privatized one. For several reasons, empirical research about the efficacy of the privatization of child welfare services is minimal to date. Multiple models exist in how privatization can be implemented in the child welfare system which makes it difficult to generalize findings and make comparisons about the research that has occurred. Jurisdictions are at varying stages of implementation which may affect the delivery of services. Often jurisdictions struggle to develop meaningful measures in which to assess outcomes. Much of the current research includes case studies and information on the lessons learned about the planning and execution of privatization in various jurisdictions. According to the Quality Improvement Center for Privatization of Child Welfare Services (QIC PCW), most research demonstrates that overall spending increased with privatization but that the accessibility of services in rural areas increased, too. Case studies that researched statewide privatization efforts like Kansas and Florida, and four other local privatization efforts revealed that neither cost savings nor dramatically greater efficiency was a well-established outcome of the efforts.

FOSTER CARE PRIVATIZATION MODELS

Florida, Kansas, and Nebraska each chose a variation of the "lead agency model" when structuring their redesigned foster care system. A lead agency may be a single non-governmental entity or composed of multiple non-governmental entities that joined together through a collaboration for the purposes of responding to a contract opportunity. The lead agency model has been the most widely used since the mid 1990s. According to the HHS, with this model,

> "the public [child welfare] agency contracts with one or a limited number of [non-governmental] agencies within a designated region to provide or purchase all specified services for the target population from the time of referral to case closure or at some other point specified in the contract."

Using the lead agency model allows the public agency to interact and monitor fewer contractors and may allow for improved coordination and service integration. Variations of the lead agency model include having the lead agency provide most or all of the services directly, or in contrast, provide few or no services and establish and administer a network of subcontractors to provide the necessary services.

Figure 1 shows distinguishing characteristics of each state's privatization efforts in comparison to what is proposed in Texas.

Each state effort was undertaken in an attempt to improve the state foster care system in response to high profile child deaths, political pressure to downsize government, poor results on the federal Child and Family Services Review, or a lawsuit. Despite the difference in the length of time to implement the redesigned foster care systems, no state's implementation went smoothly. Florida, took the "go slow" approach and implemented the new privatized community-based care system county–by-county over five years. In contrast, Kansas and Nebraska implemented their privatization efforts statewide without using pilot projects.

Each of the three states use different variations of the lead agency model. Florida's redesigned system called, community-based care (CBC), consists of 20 private lead agencies providing services to all of Florida's 67 counties. The lead agencies or CBC agencies are responsible for providing foster care and related services including family preservation, emergency shelter, and adoption. Florida also established 33 community alliances to participate with the lead agencies in resource utilization planning, needs assessment, service delivery priorities, establishing outcome goals, resource development, and promoting prevention and early intervention services. The community alliances were statutorily authorized and were developed to serve as central points for community input and collaboration about child

FIGURE 1
STATE COMPARISON OF FOSTER CARE SYSTEMS, 2012

CHARACTERISTICS	TEXAS	FLORIDA	KANSAS	NEBRASKA
Privatization Implementation date	2011 – In Progress	1996 – pilot programs 1998 – statewide	1996	2009
Geographic Area	One catchment area (combination of regions)	Implemented over 5 years, county-by-county.	Statewide	Statewide
Children in Foster Care[1]	2010 – 28,954	2010 – 18,753	2010 – 5,979	2010 – 5,358
Child Welfare Expenditures[2]	Fiscal Year 2011 – $1,380 Million	Fiscal Year 2010 – $1,020 Million	Fiscal Year 2010 – $246.1 Million	Fiscal Year 2010 – $266.8 Million
Services Privatized	All except: • Residential Child Care Licensing • Intake Reports • Investigations • Family Based Safety Services • Non-licensed Kinship Placements • Protective Daycare Services • PAL - Aftercare Services • Purchased Client Services[3] • Family Group Decision Making/Family Team Meetings • Post Adoption Services	All except: • Intake and assessment • Investigations.	All except: • Intake and Assessment, Screening • Investigation • Selected family services.	All except: • Intake and assessment, • Screening and Investigation • Safety plan development • Medical needs of state wards.
Privatization Model	Lead agency model.	Lead Agency model and Community Alliances.	Lead agency model.	Lead agency model.
Selection Process	Request for Proposals open to for-profit and non-profit entities.	Invitation to Negotiate process open to non-profit, non-public entities.	Competitive bid open to non-profits who could fully implement services upon awarding of contract.	Request for qualifications open to non-profit and for-profit entities.
Performance Measures	Yes.	• Yes, vary by lead agency contract. • Used for determining renewal.	• Yes. • Used only for long term performance tracking.	• Yes. • Used for incentives for contractors.
Payment Structure	Rate and lump sum payments.	Lump sum payment.	Rate and lump sum payments.	Lump sum payment.
Selected Outcomes	None to date.	• Mixed. • Children and family reunification within 12 months increased. • Adoptions have also increased. • Mixed outcomes in achieving permanency.	• Residential placements decreased. • Adoptions increased. • Average length of stay decreased.	• 2012 legislation returned foster care operations to state workers.

[1]Children removed from home and whom the state has responsibility for their placement, care, or supervision, regardless of eligibility for Title IV-E funds.
[2]All Funds.
[3]For families of children who do not meet referral criteria for SSCC and those receiving services as a part of the Investigation or Family Based Safety Services stage of service.
Source: Legislative Budget Board.

welfare needs and to establish community partnerships with the lead agencies. Each CBC agency differs in their organization and makeup as well as the extent to which they use subcontractors to provide services.

Kansas took a different approach and contracted with a lead agency for different foster care services. The state was sub-divided into five regions and a single lead agency was responsible for each service, such as family preservation, in a region. Adoption was the one service that received a statewide contract. Nebraska also sub-divided the state into five regions and selected lead agencies to be responsible for most foster care and juvenile justice services.

The experiences of Florida, Kansas, and Nebraska, demonstrate there is no single "best" way to pursue the privatization of foster care services. Once statewide privatization was implemented each state encountered similar issues despite the varying ways it was implemented and the differences in the characteristics of each state's system. Each state encountered serious problems in contract monitoring and contingency planning. Moreover, no state has drafted the perfect contract to remedy implementation and other ongoing issues.

FOSTER CARE REDESIGN IN FLORIDA

In their book, *An Assessment of the Privatization of Child Welfare Services: Challenges and Successes*, authors Madelyn Freundlich and Sarah Gerstenzang identify Florida's initial monitoring of contractors as being "underdone." The state struggled with issues regarding the appropriate role of state monitoring and auditing, difficulties developing a monitoring system that addressed the unique features of community-based care, and problems building internal monitoring capacity with state systems that previously lacked this function. Contract monitoring has gradually evolved and improved. At present, the key elements in Florida's monitoring plans for its foster care contractors are identified in statute. According to the statute, the Florida Department of Children and Families is required to

> "adopt written policies, and procedures for monitoring the contract for the delivery of services by lead community-based providers…[that] at a minimum address the evaluation of fiscal accountability and program operation, including provider achievement of performance standards, provider monitoring of subcontractors, and timely follow up of corrective action for significant monitoring findings related to providers and subcontractors."

After the financial failure of four of five privatization pilot projects in the 1990s and at least two additional lead agency failures occurring since then, the state recognized it was critical to have contingency plans for future lead agency failures. The state also recognized it had to address potential problems in lead agency performance that are serious, but may not rise to the level of receivership or complete service interruption.

FOSTER CARE REDESIGN IN KANSAS

Kansas' foster care system transformation has been described as "abrupt." The move to privatize foster care services occurred without input from stakeholders, such as judges, families, and case workers. Difficulty mounted during the transition when lead agencies experienced serious financial problems due to the case rate failing to meet the actual costs of the services provided.

Increased accountability for providers is one improvement resulting from Kansas' privatization efforts. Before privatization, Kansas did not have the structure in place to track service costs, contractor performance, or client outcomes. At present, contractors submit quarterly financial statements and annual audited financial statements. These documents are reviewed by state workers to identify any trends that could lead to future problems. If concerns are identified, the state works with the contractor to implement a corrective action plan and set improvement goals and time lines. The state tracks the performance of contractors but over the long term and the measures are used as a basis for contract renewal. Like Florida, Kansas lead agencies suffered cash flow problems and at least one failed due to filing for bankruptcy. State officials have prepared contingency plans in the event of future lead agency failures or severe service disruptions.

FOSTER CARE REDESIGN IN NEBRASKA

Nebraska's privatization problems emerged during the implementation phase. Contracts with six lead agencies were to be signed in November 2009. One month before, one agency pulled out of their agreement with the state after learning the state withheld $1 million from the contracted amount. In addition to other fiscal concerns, the reduced funding for the contract caused some lead agency executives to question whether the amount of money designated for the privatization contracts would be sufficient to cover costs. Five months into implementation, two lead agencies failed. Both failures were due to financial insolvency, and according to lead agency officials, specifically due to the inadequate

reimbursement rate from the state. More than 2,000 children and their families were affected by the abrupt departure of the contractors. Ten months into implementation a third lead agency terminated its contract with state approval after it experienced heavy financial losses and had to lay off workers. In total, four of the six lead agencies terminated prematurely due to significant loss of funds while carrying out the terms of the contract. By December 2010, the Nebraska Foster Care Review Board reported that the infrastructure of the child welfare system was deteriorating because foster families, therapists, and other service providers would no longer provide their services due to payment, communication, and coordination issues.

Proper monitoring of contractor expenditures by Nebraska officials has been inconsistent and troubled since privatization was initiated. Findings by the state auditor revealed "woefully inadequate" financial oversight of the lead agencies by the Nebraska Department of Health and Human Services (DHHS). A legislative committee found "the lack of basic financial planning and accountability led to millions of dollars spent on lead agencies: one that later did not participate in the contract, two that ended the contracts owing millions of dollars to subcontractors, and two that needed significant infusions of funds to continue the contracts. As a result, contrary to DHHS' stated goal to operate within existing resources, the financial audit revealed a 27 percent increase in child welfare costs between 2009 and 2011." Due to findings from both the Nebraska state auditor and the Legislative Health and Human Services Committee, as well as continued problems with lead agency performance, the Nebraska Legislature passed five child welfare bills in April 2012 that will return operation of the foster care system to the state health and human services agency in all counties except two near Omaha. According to media reports, Nebraska legislators acknowledged that "the privatization efforts has been a debacle that failed because of a lack of funding, no clear goals, and little oversight that allowed costs to soar for reasons that still aren't fully known."

FOSTER CARE REDESIGN IN TEXAS

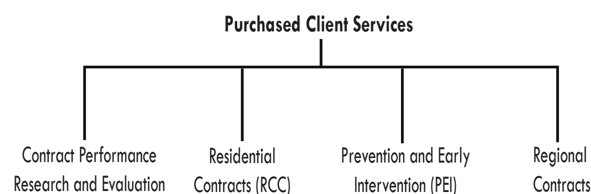
The Department of Family and Protective Services (DFPS) is directed via Senate Bill 218, Eighty-second Legislature, Regular Session, 2011, to implement a redesign of the foster care system in accordance with the recommendations contained in the department's Foster Care Redesign report submitted to the Texas Legislature. The proposed system will use a lead agency model. Under this model, DFPS will contract with a single lead non-governmental agency, also known as the Single Source Continuum Contractor(SSCC), to provide a full continuum of foster care services in one region of the state. The lead agency can either provide all the services directly or establish a network of providers to work as sub-contractors to ensure the needed services are available. Additionally, according to Senate Bill 218, the proposed redesigned system must include a payment system based on performance targets and the payment rates to be used may not result in total expenditures for any fiscal year during the 2012–13 biennium that exceed the amounts appropriated by the Eighty-second Legislature for foster care and other purchased services, except for normal entitlement caseload growth. Initially, the implementation plans for the foster care redesign initiative included two catchment areas—one metropolitan and one non-metropolitan—each with a lead agency to administer and provide foster care services in its region. In an RFP released on August 1, 2011, DFPS solicited proposals for contractors in DFPS Region 11, which includes Corpus Christi the Rio Grande Valley, and DFPS Region 2/9, which includes Abilene, Wichita Falls, Midland, and San Angelo. On June 20, 2012, two contracts to implement the redesigned system were tentatively awarded to Lutheran Social Services of the South for the metropolitan catchment area (DFPS Region 11), and to Providence Service Corporation of Texas in the non-metropolitan catchment area (Region 2/9). On August 9, 2012, DFPS announced it was rescinding the award for a metropolitan area and withdrew the award given to Lutheran Social Services of the South. DFPS staff found serious regulatory violations at three of the Lutheran Social Services' locations across the state. According to DFPS, officials have decided not to award a contract in the metropolitan area as a part of this initial procurement.

FOSTER CARE CONTRACT MONITORING IN TEXAS

The purchased client services (PCS) division within DFPS is responsible for procuring foster care services from providers and for monitoring contract compliance. **Figure 2** shows the organizational chart of the PCS division and the four subdivisions it contains.

Each of the four subdivisions in the PCS division is responsible for overseeing services contracts for their respective area, with the exception of the Contract Performance Research and Evaluation subdivision which is responsible for developing contract performance measures and gathering and reporting performance data for the three types of service contracts. The Residential Contracts subdivision oversee licensed residential child-care providers

FIGURE 2
FOSTER CARE PURCHASED CLIENT SERVICES ORGANIZATIONAL CHART, 2012



SOURCE: Texas Department of Family and Protective Services.

who provide substitute care to children in DFPS's managing conservatorship. The Regional Contracts subdivision manages various client service contracts that provide services, such as child day care services, post adoptive services, evaluation and treatment services, psychological services, parent-caregiver training, and others. The Prevention and Early Intervention (PEI) subdivision manages community-based programs that prevent juvenile delinquency and child maltreatment. Through these contracts, PCS staff establishes the qualifications, standards, services, expectations, and outcomes to be met by the contractor. The contract monitoring functions of PCS staff includes making on-site visits, reviewing contract activities, and documenting the programmatic and financial accountability of each contractor. Contract staff is also responsible for processing the payment for these services.

To enhance internal communication and coordination in the monitoring of residential contracts, DFPS officials created the Facility Intervention Team Staffing (FITS). Issues brought to the FITS team are concerns or patterns exhibited by a provider that are in need of improvement. Two FITS teams address these issues. A smaller or core FITS team consists of staff from the legal division and from the three areas that regularly interact with residential contract providers: licensing, contract monitoring, and CPS program or caseworkers. The core FITS team meets every other week and may take up issues as a preventative measure to solve problems before they become larger or to address a crisis situation. A second, larger, executive FITS team makes decisions on what type of action, if any, is needed to correct issues brought before the core FITS team. The executive FITS team meets monthly and includes a licensing attorney, a contract attorney, the assistant commissioners of child protective services and licensing, and the director of purchased client services, directors of residential contracts and residential child care licensing, and various subject matter experts.

In addition to the contract monitoring activities conducted by the PCS staff, DFPS' Contract Oversight and Support (COS) division develops a Statewide Monitoring Plan (SMP) each year to determine which child welfare contracts are of greatest risk to the state. The SMP prioritizes contracts that must be monitored based on a risk assessment completed by contract management staff. The risk assessment used to develop the SMP is a standard tool to evaluate essential characteristics of client service contracts and the levels of associated risk that each contract holds for the state. Risk is defined as the possibility or likelihood that loss, harm, or damage may occur due to errors or problems related to the day-to- day operations of a contractor.

The top 20 percent of the highest risk client services contracts across the state are placed on the SMP. The SMP identifies the monitoring level and method used for each contractor. The monitoring level is either "full" or "targeted." Full monitoring requires both a programmatic and fiscal review and a three-month testing sample of data, while targeted monitoring will review programmatic and/or fiscal data and a two-month testing sample of data. Monitoring methods include: on-site visit, desk review, or billing review. The on-site review is more involved than both a desk and billing review because it is a formal review of the contractor's financial, personnel, service, client records, program activities, and takes place at the provider's location. A desk review examines documentation about the contractor's service delivery or business operations, while a billing review looks at the contractor's monthly billings. Both are conducted away from the contractor's offices.

CONTRACT MONITORING OF LEAD AGENCIES IN TEXAS

In preparation for the Foster Care Redesign initiative DFPS staff consulted with staff from the Health and Human Services Commission (HHSC) about methods that could be used to monitor the lead agency contract. HHSC staff, through their experience and knowledge from monitoring the Medicaid program contracts, shared information with DFPS staff about the potential challenges large, high risk contracts pose. As of December 2012, DFPS officials remain in final contract negotiations with Providence Service Corporation of Texas. Consequently, detailed monitoring tools that incorporate requirements of the final contract are not yet developed and specific information about how the lead agency contract will be monitored is not final.

According to DFPS, a data and performance "dashboard" to track the lead agency's monthly performance will be created.

How the lead agency monitors its subcontractors has also been identified as an area DFPS intends to monitor closely.

DFPS officials are considering using a team approach to monitor the lead agency contract. Tentatively, the department is proposing to use two teams: one staffed locally in the region and the other at the state office in Austin. The regional team would oversee implementation issues and document process changes, as well as manage the day-to-day contract issues that may arise. The state office team would conduct at least one annual on-site monitoring visit to the region and focus on identifying long term issues or trends in monitoring the lead agencies. The state office team would consist of four staff who would monitor the following contract areas: financial, administration, programmatic, and performance. **Figure 3** shows examples of the proposed types of information and data the state office team would monitor.

FIGURE 3
EXAMPLES OF CONTRACT INFORMATION TO BE MONITORED, 2012

CONTRACT AREA	INFORMATION TO BE MONITORED
Financial	• Viability of lead agency • Cash flow • Cash balances • Profitability • Legal issues/lawsuits
Administration	• Administration of provider network • Monitoring of sub contractors
Programmatic	• Client services • Client outcomes
Performance	• Data and metrics from client services • Performance measures

SOURCE: Texas Department of Family and Protective Services.

DFPS reports that the lead agency contract will be on the SMP each year due to the large amount of the contract and the newness in how the department contracts for child welfare services. It will be the first non-residential contract to be placed on the SMP. Placement on the SMP means that DFPS staff will conduct annual on-site monitoring and that the lead agency will submit monthly and/or quarterly performance data for tracking. DFPS has determined that the lead agency is a sub-recipient per the federal definition and due to this designation, the lead agency will be required to provide certain financial information to DFPS to ensure compliance with federal circular A-133 requirements.

Despite DFPS's current and proposed monitoring activities for the lead agency, implementing the lead agency model is an entirely new way for DFPS to purchase services for the foster care system. While the agency has a history of contracting with multiple small providers for various services independent of one another, DFPS does not have experience monitoring one contractor who is the linchpin for providing all services for an entire Texas region.

DFPS did not take advantage of the feedback and collective experience of the statutorily established interagency Contract Advisory Team (CAT) when drafting its procurement documents. The CAT is required to review and provide feedback to agencies that are procuring services in excess of $1 million. In practice and due to workload, the CAT staff at the Comptroller of Public Accounts (CPA) reviews procurements less than $10 million. The full interagency CAT team reviews procurements of $10 million and more. While DFPS did submit the foster care privatization procurement to the CAT as required, a full review was not conducted by the CAT because DFPS identified the contract value to be only $1 million and did not indicate it was a new service being contracted.

Moreover, the experience of other states implementing large-scale reform by privatizing their foster care system demonstrates that during implementation states can encounter delays and problems, many of which are related to inadequate contract monitoring. Specifically, each state discussed previously experienced the failure of a lead agency during and since implementation. In Florida's case, it lacked a system for early identification of lead agency problems, such as benchmarks or measures that can be used as early warning indicators to detect problems with the long term viability of a lead agency.

Despite DFPS' proposed monitoring efforts, the department is not required to implement an early warning system containing benchmarks to act as early warning indicators in the monitoring of a lead agency's viability. This means that the department could modify its proposed approach for monitoring. Recommendation 1 would amend statute to require DFPS to incorporate into its current contract monitoring activities, a system or process that would collect and monitor data and information that could be used for the early identification of lead agency problems and the evaluation of lead agency viability. Additionally, DFPS should develop a procedure to ensure ongoing analysis of the data, documentation of the findings and any corrective action taken, such as additional reviews of greater depth of

the lead agency once early warnings are triggered about its viability, and report to the Legislative Budget Board (LBB) and the Office of the Governor annually about its findings. This recommendation would reduce the risk that the state will be unprepared to intervene if a lead agency experiences performance difficulties.

Figure 4 lists warning indicators suggested by the Florida Auditor General's office that should be monitored by state child welfare agencies because of the indicators' impact on a lead agency's long-term viability.

FIGURE 4
SELECTED MANAGEMENT AND PERFORMANCE INDICATORS FLORIDA STAFF USES TO MONITOR CONTRACTORS' FISCAL VIABILITY, 2004

- An existence of internal audit function reporting directly to the board; existence of significant or recurring issues; appropriate corrective action
- The use of risk management; the extent the lead agency is covered by performance bonds and other insurance
- A comparison of actual expenditures to budget; analysis of variances
- An adherence to approved costs plan; portion of total costs not directly allocatable; appropriate funding source allocation and client population utilization
- The timeliness of payments to vendors/sub recipients; accuracy and timeliness of invoices to state agency
- The composition of management, administrative, direct care, and other program staff; ratio of administrative to direct staff
- The number of vacancies; space percentage of positions filled; trend of vacant positions and identification of causes
- The program structure such as: caseload size; average length of stay; age of children; percentage in-home versus out of home; available support services for active families; prevention/diversion services; percent of corporate value of state contract.

Source: Florida Office of Program Policy Analysis and Government Accountability.

Using a lead agency model is a benefit to DFPS because it reduces the number of providers the department must monitor. However, a disadvantage to the model is that one provider will assume sole responsibility for service provision in a larger area of the state. Reducing the risk to the state should a lead agency fail is critical given the role lead agencies play in the redesigned foster care system. In the legacy foster care system, when a contractor fails, additional providers or a new provider assume the role left by the failed contractor. Minimal service interruption is caused to the overall foster care system because services are distributed among many providers. In the redesigned system, failure of a lead agency increases risk because the lead agency is the sole DFPS contracted provider in the area. Solutions used in the legacy system may not be able to be implemented or may require significant time to implement due to the larger population that would be affected simultaneously and the varying needs each client has. Florida addressed this problem after experiencing multiple lead agency failures and recognizing the inherent risk to the state in using the lead agency model by statutorily limiting the amount of direct services a lead agency could provide. The purpose of the statute is twofold: it encourages the lead agency to work with other providers in the region and limits the amount of services to be replaced in the event of a lead agency failure.

Recommendation 2 would amend statute to limit the direct provision of services provided by a single lead agency in its specified geographic area so that it may not exceed 35 percent of total expended amounts of the contract. This percentage is consistent with the threshold established by Florida. The DFPS should establish by rule a methodology to determine a lead agency's compliance. The service limit should be calculated based on the total expenditures for services provided, not by individual service categories to allow the lead agency flexibility in structuring how it will provide services to fulfill the terms of the contract. A process should be established to authorize a temporary six-month exemption to the service limit in the catchment areas where a limited provider base exists. To qualify for the temporary exemption, a lead agency should be required to demonstrate to DFPS the lack of necessary providers by working with county child welfare boards in the catchment area. The lead agency would also identify steps it would take to increase the number of providers so that statutory compliance occurs at the end of the exemption period.

Ensuring a diversified provider base in the redesigned foster care system also creates an additional layer between DFPS and the clients they serve. The further removed a government entity is from the population it serves, the greater the risk the government assumes regarding the delivery of services as required by the contract. To prevent gaps in accountability and increase the transparency of a lead agency's operations, Recommendation 3 would amend the Texas Government Code Section 2155.1442 to require the Health and Human Services Commission (HHSC) to contract with the State Auditor's Office (SAO) to conduct fiscal and programmatic audits of each lead agency contracting with DFPS in the redesigned foster care system as necessary. According to the

Texas Government Code Section 2155.1442, the SAO is authorized to conduct annual on-site audits of selected residential child care providers that contract with DFPS to provide foster care services. Given the central role a lead agency plays as a child welfare provider in the redesigned foster care system, it is vital the state receives a recurrent and independent analysis of the financial and programmatic operations of a lead agency.

A well-trained and competent contract monitoring staff is vital to the oversight of lead agencies and their performance. As of fiscal year 2012, not all contract monitoring staff within DFPS' purchased client services division has attended training required by the Texas Government Code, Section 2262.001. To comply with the statute, HHSC contracted with the University of Texas LBJ School of Public Affairs to develop training that would be more appropriate for contract managers of health and human service agencies and meet the requirements of the Government Code. **Figure 5** shows the estimated percentage of DFPS contract monitoring staff from the purchased client services division that have attended this training. The percentage of full-time equivalents (FTE) positions in compliance with statute is based on the number of current employees as of May 2012 for each division and the current number of FTE positions as of April 2012 that completed the statutorily required training.

According to an April 2010 DFPS' internal audit report, 25 percent of the agency's contract management and oversight staff that perform fiscal review activities did not feel they had sufficient training or knowledge to perform fiscal monitoring activities or to review the work of others who performed these activities. Thirty percent were "unsatisfied" or "very unsatisfied" with the quantity and quality of the training provided by the department. A lack of sufficient training weakens the entire contract oversight structure because contract management staff is the primary resource used to ensure contract compliance occurs and provides timely, initial warning of emerging or imminent problems.

Recommendation 4 would include a rider in the introduced 2014–15 General Appropriations Bill to direct the department to provide their contract management staff with sufficient on-going training to ensure the staff's ability to perform fiscal and financial analysis and oversight of the lead agencies' contracts. DFPS' internal audit division should survey contract monitoring and oversight staff annually to measure the affect the additional training has on staff satisfaction and their view of their ability to perform the required fiscal analysis and financial monitoring. The internal audit division should make their findings available to the DFPS commissioner and other relevant staff.

The use of performance measures is a part of oversight activities that allow government entities to determine if contract goals are being achieved. Performance measures can assess the efficiency of a lead agency's operations, the status of client outcomes, and allow for some comparison between the legacy and redesigned foster care systems. In the 2012–13 General Appropriations Act, Rider 25 requires DFPS to report on the expenditures and outcomes for children, youth, and families based on quality indicators identified in the DFPS' Foster Care Redesign report. Together, DFPS and LBB identified additional measures for reporting that will provide a more thorough understanding of the affect foster care redesign is having in the region where it is being implemented and allow for analysis and comparison between the two systems.

Recommendation 5 would include a rider in the introduced 2014–15 General Appropriations Bill to require the department to continue to report on the selected performance measures identified by LBB and require DFPS to provide a report that contains the most recent data for the selected performance measures, an analysis of the data that identifies trends and related impact occurring in the redesigned foster care system, identification and analysis of factors negatively impacting any outcomes, recommendations to address problems identified from the data, and any other information

FIGURE 5
TRAINING STATUS OF CONTRACT MONITORING STAFF, PURCHASED CLIENT SERVICES DIVISION, 2012

DEPARTMENT OF FAMILY AND PROTECTIVE SERVICES DIVISION	FTE POSITIONS WITH STATUTORY TRAINING REQUIREMENT	FTE POSITIONS WITH COMPLETED STATUTORY TRAINING REQUIREMENT	PERCENTAGE OF FTE POSITIONS IN COMPLIANCE
Regional Contracts	29	14	48%
Residential Contracts	23	19	82%
Prevention and Early Intervention Contracts	9	1	11%

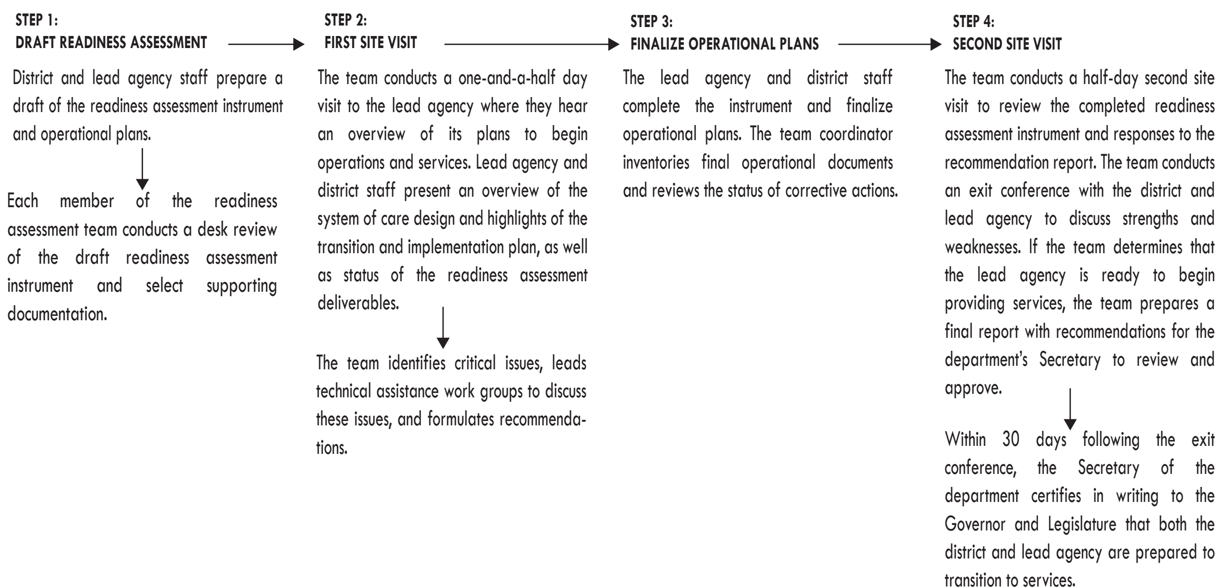
FTE = Full-time-equivalent positions.
Source: Texas Department of Family and Protective Services.

necessary to determine the status of the redesigned foster care system. The report would be prepared in a format specified by the LBB and would be submitted August 1 and February 1 of each year of the biennium. The report should be provided to the LBB, the Office of the Governor, the Committee on House Appropriations, the Committee on Senate Finance, the House Committee on Human Services, and the Senate Committee on Health and Human Services.

Problems related to financial stability, data integrity, and high staff turnover are factors that adversely affected the performance of some lead agencies in Florida and impacted the continued roll out of the redesigned privatized foster care system in 2002 and 2003. Consequently, the Florida legislature required future lead agencies to go through a formal readiness assessment and process to head off any problems before assuming the contracted responsibilities. **Figure 6** shows key steps in Florida's readiness assessment process.

In preparation for implementation of the Texas redesigned foster care system, DFPS has not established a process to determine a lead agency's operational readiness. Recommendation 6 would amend statute to require DFPS to develop, with input from the lead agency, a process and an assessment tool to gauge the operational readiness of a lead agency's ability to assume their contracted responsibilities. The review process should include an assessment instrument with criteria reflecting national accreditation standards, contractual requirements, and at a minimum address contractor operations related to programmatic, financial, data collection and information technology security, staffing levels, sub-contractor monitoring procedures, handling of consumer complaints, as well as other factors DFPS determines to be useful. DFPS should develop the standardized statewide instrument with appropriate lead agency staff to ensure realistic criteria are used to assess the lead agency's readiness to begin service delivery and accept clients. The purpose of the process and assessment instrument is to identify any lead agency weaknesses that would adversely affect the delivery of services to clients so that corrective actions can take place before the transfer of certain foster care services. DFPS should by rule determine the specific steps required of the readiness assessment process and composition of the assessment team based the Florida model. At a minimum, the process should include two on-site visits (to the lead agency and other necessary locations) with the first occurring within the first four months of the signed contract and the second occurring 30 to 45 days before the anticipated effective date of accepting clients and an assessment team composed of no less than four total members. The team should be composed of two members from DFPS, one each from the state and regional offices and two stakeholders. The two stakeholder positions should be chosen from a regional or county branch of Court Appointed Special Advocates

FIGURE 6
FLORIDA'S LEAD AGENCY READINESS ASSESSMENT PROCESS FLOW CHART, 2004



SOURCE: Florida's Office of Program Policy Analysis and Government Accountability.

(CASA), DFPS Advisory Council, or a local child welfare board. DFPS should establish a rule to allow nominations from these groups with the DFPS Commissioner selecting the participating stakeholders for the readiness assessment. The two volunteer stakeholders should not be employees of any lead agency or its subcontractors or have a conflict of interest while acting as a readiness assessment team member. The DFPS commissioner should receive a copy of each completed readiness assessment and make a decision about whether to certify that a lead agency's preparations are sufficiently ready for the state to transfer responsibility of service delivery to them.

In addition to ensuring readiness before the transfer of certain foster care services to a lead agency, it is equally important DFPS have appropriately detailed contingency plans to handle a lead agency failure or other crisis. In the legacy system when a provider fails or contract is not renewed, clients often are transferred to other providers. Transferring clients may not be feasible if the lead agency is the sole provider in the area. At present, DFPS lacks sufficiently detailed contingency plans for the failure of lead agency or for a substantial disruption of services in the area of the state the lead agency serves. DFPS also lacks sufficiently detailed intervention plans that are progressive and adaptable to the size and scope of the problem identified.

Recommendation 7 would amend statute to require DFPS to develop a progressive intervention plan and contingency plan for the continuity of foster care service delivery in areas of the state served by a lead agency. At a minimum the contingency plan(s) would contain specific action to be taken by specific DFPS and lead agency staff to address various types of events. These include: financial emergencies with one or more lead agencies simultaneously, incidents of abuse or death of children while in the care of a lead agency, serious violations of state or federal law, security breaches of electronic or other data at a lead agency or subcontractor, as well as other foreseeable situations. The plan(s) should be of sufficient detail so that in a crisis affected DFPS staff knows their roles and responsibilities and whom to contact. The plan should identify a communication plan to pass on information to clients and their families, caseworkers, stakeholders, state officials, media, and other relevant parties. Timetables for the transfer of relevant operations and materials, such as staff, records, and funding should also be identified, as well as how DFPS staff will assist with day-to-day operations until a new procurement can be completed. Copies of the plan(s) should be provided to the LBB, Office of the Governor, DFPS Advisory Council, and the HHSC Commissioner no later than December 1, 2013.

The progressive intervention plan should, at a minimum, plan for a range of potential problems that do not rise to the level of crisis but should be addressed before their severity increases and affects the viability of the lead agency. The plan should identify timetables and the responsibilities and steps to be taken to correct the problem by specific DFPS and lead agency personnel. Consequences of inaction by the lead agency to correct the problems should also be identified.

During the implementation of the redesigned foster care system, the legacy foster care system will continue to operate within the region where redesign is occurring and across the state until the transition to the redesigned system is completed. According to DFPS, children in the foster care system where redesign is occurring will not be moved from DFPS' care solely for the purposes of moving the child to be under the lead agency's care. These children will not be under the lead agency's purview until they require a placement change per their care plan.

The ongoing operation of two foster care systems creates the potential for gaps in service delivery and miscommunication to occur among contractors and DFPS. Establishing a clear division of responsibilities and communication between state case-workers and private contract workers will take time and ongoing effort. During the transition period, it remains important for the appropriate staff to provide timely and accurate information to presiding judges about a child's case and if court-ordered services are being provided. Establishing a safety net, independent of DFPS, to ensure the court hears what is in the child's best interests would be beneficial and help prevent gaps in a child's care from occurring in the legacy or redesigned system.

Guardians ad litem (GAL) are well positioned to ensure timely communication with the court occurs. GALs can be, but are not always attorneys. GALs represent the best interests of the child to the court, while attorneys who are not acting as GALs represent the stated interests of their client or what their client asks them to do. Sometimes the stated interests of a child in foster care are not always in the child's best interest. Through the representation of an attorney and a GAL, both interests, stated and best, are presented in court hearings. The Texas Family Code mandates appointment of GALs in a suit filed by a governmental entity seeking termination of parental rights or the appointment of a conservator for a child. The judge is the final arbiter of a child's case who has entered the foster care system after being removed from home. To ensure

children do not remain in the foster care system longer than needed, the Texas Family Code has specific time lines in which permanency for a child must be achieved. Without accurate and timely information, judges cannot assess a child's progress and make meaningful recommendations about a child's welfare and it may be more difficult to comply with statutory time lines.

In the redesigned system, judicial concern exists about how to ensure accountability for the timely delivery of court-order services because the lead agency is not a legal party to the parent-child law suit as DFPS is. In the legacy system if DFPS was not providing a court-ordered service, then a judge could cite the department for contempt of a court order. However, contempt citations may only affect person/entities that are designated as a legal party to the law suit. In the redesigned system, the additional layer of a lead agency to the foster care system inhibits judges' ability to ensure accountability when it comes to the timely delivery of services for children and families.

Recommendations 8 would amend statute to require GALs appointed to child protective services cases to be required to notify appropriate court personnel before the next scheduled court hearing if a court order is not being complied within a reasonable amount of time. Jurisdictions that would prefer not to use this requirement in their courts would have ability to opt out. This amendment would provide judges in child protective services cases with an additional mechanism to receive information regarding compliance to court orders and if the needs of child are being met.

FISCAL IMPACT OF THE RECOMMENDATIONS

There is no associated fiscal impact with implementing Recommendations 1 which would require DFPS to incorporate into its current contract monitoring activities, a system or process that would collect and monitor data and information that could be used for the early identification of lead agency problems and evaluating lead agency viability. It is assumed DFPS and the lead agencies could use an existing information technology system to collect and monitor the additional data.

Recommendation 2 would amend statute to ensure a diversified provider base exists in areas where the redesign foster care is being implemented. No fiscal impact to DFPS is assumed.

Recommendation 3 would direct DFPS and the Health and Human Services Commission to arrange for fiscal and programmatic audits of the lead agency through a previously established Interagency Contract with the SAO. It is assumed any cost associated with this recommendation would not have a significant fiscal impact and could be funded with existing resources.

Recommendation 4 directs DFPS to provide their child protective services' contract monitoring staff with sufficient on-going training to ensure the staff's ability to perform fiscal and financial analysis and oversight of the lead agencies' contracts. It is assumed any cost associated with this recommendation would not have a significant fiscal impact and could be funded with existing resources.

Recommendation 5 would require DFPS to report performance measures for the areas of state implementing foster care redesign and report to the Legislative Budget Board, Office of the Governor, the House Appropriations Committee, the Senate Finance Committee, the House Human Services Committee, and the Senate Health and Human Services Committee. It is assumed DFPS could implement Recommendations 5 within existing resources.

Recommendation 6 would amend statute to require DFPS to establish a process and develop an assessment to gauge the operational readiness of lead agencies' ability to assume their contracted responsibilities. It is assumed a portion of the costs to develop a readiness assessment process and instrument could be defrayed by DFPS staff seeking assistance from Florida state officials or other jurisdictions that have experience in the development of these tools. It is assumed any cost associated with this recommendation would not have a significant fiscal impact and could be funded with existing resources.

Recommendation 7 would require DFPS to develop intervention plans that address lead agency deficiencies and a sufficiently detailed emergency contingency plan to ensure continuity of services in the event of a lead agency failure. It is assumed DFPS could implement this recommendation within existing resources.

Recommendations 8 would amend statute to require guardians ad litem appointed to child protective services cases to be required to notify appropriate court personnel before the next scheduled court hearing if a court order is not being complied within a reasonable amount of time. It is assumed this recommendation could be implemented within existing resources of the judiciary.

The introduced 2014–15 General Appropriations Bill includes a rider to implement Recommendations 4 and 5.

IMPLEMENT ADDITIONAL COST CONTAINMENT STRATEGIES FOR FOSTER, RELATIVE, AND PROTECTIVE DAYCARE SERVICES TO MAXIMIZE THE NUMBER OF CHILDREN SERVED

In fiscal year 2011, an average of 9,000 children per month received foster, relative or protective daycare services funded by the Texas Department of Family and Protective Services. Daycare services the agency funds are not statutorily required. The purpose of these services is to recruit and retain qualified foster families, to reunify families and place children with relatives whenever possible, and to preserve families in crisis.

The agency manages daycare services by setting eligibility standards such as age limits. It has recently taken steps to improve the service authorization process by standardizing employment verification and implementing controls to ensure that unauthorized services are not funded. However, the demand for childcare services is increasing and the agency's expenditures for services exceeded appropriated amounts for the last three biennia. The agency projects that the monthly average number of children expected to receive foster, relative or protective daycare services will increase each year from fiscal years 2012 to 2015. Expenditures for all types of daycare services are projected to increase by 6 percent from fiscal years 2011 to 2015, or by $2.1 million.

As the demand for state-funded daycare services increases, the Texas Department of Family and Protective Services should explore additional cost-containment strategies. By implementing these strategies for daycare services, the agency could ensure the cost effectiveness and efficiency of the program and maximize the number of clients the program serves.

CONCERNS

- The Texas Department of Family and Protective Services lacks a standardized and documented process to verify that daycare services are a provider of last resort for relative and foster caregivers. As a result, there is a risk that state-funded daycare services are authorized for children who could receive services elsewhere.
- The Texas Department of Family and Protective Services projects that the monthly average number of children receiving daycare services will increase by 15 percent from fiscal years 2012 to 2015. Although the agency has taken steps to manage utilization, without additional controls the agency risks not meeting the increased demand for daycare services.
- The Texas Department of Family and Protective Services collects data on the number of children and families who receive daycare services; however, the agency does not collect data on family size or income levels. Without this data, it is difficult to assess the population served and to determine the feasibility of implementing certain cost containment strategies such as requiring a parent fee on a sliding fee scale basis for relative and foster caregivers.

RECOMMENDATIONS

- **Recommendation 1:** Amend statute to require that the Texas Department of Family and Protective Services implement a standardized and documented process for verifying that kinship caregivers and foster parents have attempted to find appropriate services to care for a child through community services before the authorization or reauthorization of daycare services through the agency.
- **Recommendation 2:** Include a rider in the introduced 2014–15 General Appropriations Bill to require the Texas Department of Family and Protective Services to identify and implement appropriate cost-containment strategies for state-funded daycare services. Strategies that the agency could employ include but are not limited to the following options: (1) creating client priority groups (2) instituting waiting lists based on client priority (3) implementing an income-based sliding fee scale for daycare services on a case-by-case basis (4) setting time limits on the receipt of services or cost-sharing exemptions.
- **Recommendation 3:** Include a rider in the introduced 2014–15 General Appropriations Bill to require the Texas Department of Family and Protective Services to collect income and family size data on clients that receive relative or foster daycare services during the authorization and reauthorization process.
- **Recommendation 4:** Include a rider in the introduced 2014–15 General Appropriations

Bill to require the Texas Department of Family and Protective Services to evaluate the impact of implemented cost containment strategies for daycare services. The agency should submit a report to the Governor's Office and the Legislative Budget Board by September 1, 2014.

DISCUSSION

The Child Protective Services (CPS) Division at the Texas Department of Family and Protective Services (DFPS) investigates reports of abuse and neglect of children. CPS provides services to children and families in their own homes, makes referrals to community services and/or petitions the court to remove a child from the parents' custody and place the child in care outside of the child's home of origin (substitute care). If children are in the custody of the state or at risk of entering state custody, they can be placed in either foster care, kinship care, or may receive family-based safety services.

FOSTER CARE

When a child is under the legal responsibility of DFPS and cannot be placed with a relative or close family friend, the court will request CPS to place the child in temporary foster care until a permanent living arrangement can be obtained. Foster care placements can include arrangements in a foster home, foster group home, institution, residential treatment facility, or juvenile facility. A foster parent must be licensed or verified as a foster parent by CPS. Of the children who were under DFPS legal responsibility at the end of fiscal year 2011, 16,596 children, or 55 percent of the children, were placed in foster care.

Foster caregivers receive reimbursement for room, board and supervision based on daily rates for a child's service level. A child's service level is dependent on their needs and is categorized as basic, moderate, specialized or intense. **Figure 1** shows the minimum daily amount to be reimbursed to a foster family by service level for fiscal years 2010 and 2011.

FIGURE 1
MINIMUM DAILY AMOUNT REIMBURSED TO A FOSTER FAMILY, FISCAL YEARS 2010 AND 2011

SERVICE LEVEL	REIMBURSEMENT AMOUNT
Basic	$22.15
Moderate	$38.77
Specialized	$49.85
Intense	$88.62

Source: Texas Department of Family and Protective Services.

In addition to monetary reimbursement, foster caregivers receive the following services:

- healthcare services for the child through the STAR Health Program;
- Access to the Preparation for Adult Living program to assist teens by providing life skills;
- one-on-one support from the foster caseworker; and
- Foster daycare services if the caregiver works full-time.

Although foster daycare services are not statutorily required, DFPS provides daycare for foster children to help ensure the recruitment and retention of qualified foster families.

KINSHIP CARE

A "kinship caregiver" is a term DFPS uses when referring to relatives, close family and friends, and others who have a long-standing relationship with a child or youth. Non-biologically related kinship caregivers are also referred to as fictive kin, or designated caregivers. Of the children who were under DFPS legal responsibility at the end of fiscal year 2011, there were 9,858 children, or 33 percent, placed with a kinship caregiver. Support services provided for kinship placements may include the following benefits:

- monetary assistance for income-eligible caregivers;
- healthcare services for the child through the STAR Health program;
- counseling, special needs training and caregiver training;
- one-on-one support by the kinship caseworker; and
- relative daycare services for caregivers that work full-time.

Texas statute allows eligible kinship caregivers to be reimbursed for daycare expenses incurred for age-appropriate children. Relative daycare is provided to support kinship placements and help children remain in relative and fictive kin homes and out of paid foster care.

PROTECTIVE CARE

CPS provides in-home Family Based Safety Services (FBSS) to help stabilize a family and reduce the risk of future abuse or neglect. FBSS includes family preservation services and family reunification services. Family preservation services are provided to a child and their family without removing the

child from the home. Family reunification services are provided to a child and their family as a child is returning home from court-ordered substitute care. In fiscal year 2011, a monthly average of 15,187 families received family based safety services. Families getting family based safety services may receive services such as family counseling, crisis intervention, and protective daycare services.

Protective daycare services are intended to preserve families in crisis. According to DFPS, adequate daily supervision for children involved in the DFPS' system ensures that parents can focus on employment and comply with their service plans. The intent of these plans is the preservation of their children in their home or the return of their children from out-of-home care. Childcare centers provide additional oversight by monitoring a child's health and well being on a day-to-day basis. DFPS may also provide protective daycare services to families during the investigative stage of setting up a child's new placement, and for children who are in a kinship placement with caregivers who are not verified foster parents and who do not meet eligibility criteria for relative daycare.

DFPS-FUNDED DAYCARE SERVICES

The CPS program is responsible for establishing daycare policies based on Federal law relating to Title IV-E funding, the federal Childcare and Development Block Grant (CCDBG), state law, and agency rules and policies. The CCDBG provides funding to states, territories and tribes and assists eligible low-income families in finding childcare services so they can work or attend training or education activities. The program also aims to improve the quality of childcare and coordination among early childhood development and after school programs. Title IV-E Federal Funds helps states provide safe and stable out-of-home care for children until a child can return home or is placed in planned arrangements for permanency. Funds are available for monthly maintenance payments for eligible foster care providers, administrative costs, training, recruitment and other related expenses. DFPS-funded child daycare services are subject to the availability of funding and are not a guaranteed service for any client.

CPS field staff at the 11 DFPS regional offices includes caseworkers and regional daycare coordinators (RDCC). Field staff assess a child's and caregiver's needs, determine eligibility and authorizes foster, relative and protective daycare services.

DFPS contracts with the Texas Workforce Commission (TWC) to provide child daycare services for children DFPS determined eligible for services. An interagency contract is negotiated every two years between the agencies, and TWC provides childcare services as long as DFPS authorizes and funds the services. DFPS is responsible for reimbursing TWC for any administrative costs incurred by the agency and its subcontractors.

TWC contracts with 28 local workforce development boards across the state that plan and oversee state and local workforce development and job training programs. The local workforce development boards subcontract with Child Care Management Services Agencies (CCMS), which provide and manage the network of childcare providers that offer state and federally funded childcare. The amount of money that DFPS reimburses TWC for childcare services is based on expenditure and client information provided to DFPS from TWC. In fiscal year 2010, TWC provided childcare services for 233,163 unduplicated children. Children with DFPS-related cases accounted for 6 percent of TWC's total caseload, or about 14,000 children.

UTILIZATION OF DAYCARE SERVICES

In fiscal year 2011, the monthly average number of children who were in foster care, relative care or who received family based safety services, was approximately 72,000 per month. Of this monthly average number of children, 15 percent of them received daycare services. **Figure 2** shows the monthly average number of unduplicated children who received foster, relative or protective daycare services from fiscal years 2006 to 2011.

From fiscal years 2006 to 2011, the monthly average number of children who received any type of daycare service increased by 55 percent. In fiscal year 2011, children who received foster daycare received services for an average of 88.3 days or

FIGURE 2
MONTHLY AVERAGE NUMBER OF CHILDREN RECEIVING DAYCARE SERVICES
FISCAL YEARS 2006 TO 2011

FISCAL YEAR	FOSTER DAYCARE	RELATIVE DAYCARE	PROTECTIVE DAYCARE
2006	1,696	556	3,580
2007	1,969	1,478	3,083
2008	1,949	1,826	3,336
2009	1,874	1,870	3,959
2010	2,048	1,912	4,725
2011	2,514	1,947	4,530

Source: Texas Department of Family and Protective Services.

approximately three months. Children who received relative daycare received services for an average of 114.2 days, and children who received protective daycare received services for an average of 63.2 days.

From fiscal years 2012 to 2015, DFPS projects that the monthly average number of children receiving daycare services will increase by 11 percent for foster daycare and relative daycare; and 20 percent for protective daycare. In contrast, DFPS projects that the monthly average number of children who will be served in foster care will increase by 5 percent for the same period. **Figure 3** shows the monthly average number of children expected to receive daycare services by fiscal year and type of care.

FIGURE 3
MONTHLY AVERAGE NUMBER OF CHILDREN EXPECTED TO RECEIVE DAY CARE BY FISCAL YEAR AND TYPE OF CARE FISCAL YEARS 2012 TO 2015

FISCAL YEAR	FOSTER DAYCARE	RELATIVE DAYCARE	PROTECTIVE DAYCARE
2012	2,256	1,777	3,775
2013	2,325	1,937	4,193
2014	2,462	1,956	4,363
2015	2,501	1,976	4,541

Source: Texas Department of Family and Protective Services.

APPROPRIATIONS FOR DFPS DAYCARE SERVICES

Daycare services are funded in the 2012–13 General Appropriations Act in the DFPS' bill pattern in three strategies: B.1.3. Foster Daycare, B.1.4. Relative Daycare, and B.1.5. Protective Daycare. These three daycare services strategies were appropriated $71 million in the 2012–13 biennium. From the appropriated amounts, 52 percent was designated for protective daycare services, 26 percent for relative daycare services and 22 percent for foster daycare services.

DFPS Daycare services are financed through a combination of General Revenue Funds, and Federal Funds—Title IV-E FMAP (federal match) and the federal Child Care and Development Block Grant (CCDB grant). **Figure 4** shows how each type of daycare was financed in fiscal year 2011.

DFPS requests funds for daycare services in the biennial Legislative Appropriations Request through the baseline request and exceptional item requests. From fiscal years 2006 to 2011, the amount that the agency spent on daycare services exceeded appropriated amounts. In the 2006–07 biennium, DFPS spent 13.4 percent more on daycare services than appropriated, 30.4 percent more in the 2008–09 biennium and 22.3 percent more in the 2010–11 biennium.

FIGURE 4
METHOD OF FINANCE FOR RELATIVE, FOSTER AND PROTECTIVE DAYCARE SERVICES, FISCAL YEAR 2011

METHOD OF FINANCE	FOSTER DAYCARE	RELATIVE DAYCARE	PROTECTIVE DAYCARE
Percentage from General Revenue Funds	36	83	41
Percentage from Federal CCDB Grant	17	17	59
Percentage from Federal Title IV-E Funds	47	0	0

Source: Legislative Budget Board.

Rider 30 in DFPS' bill pattern of the 2012–13 General Appropriations Act requires the agency to obtain prior written approval to spend more than the amounts appropriated for daycare services during the biennium. In May 2012, DFPS estimated that the 2012–13 biennial shortfall for daycare services was approximately $8.5 million due to higher than expected caseloads.

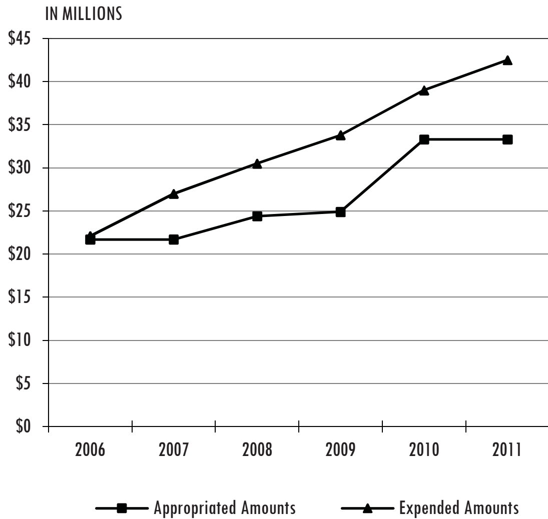
Figure 5 compares appropriated and expended amounts for all DFPS daycare services for fiscal years 2006 to 2011.

Figure 6 shows the trend of expended amounts for foster, relative and protective daycare services from fiscal years 2006 to 2011. From fiscal years 2006 to 2011, expenditures for daycare services increased by 92 percent. Some of the growth in expenditures can be attributed to the start of relative daycare services in fiscal year 2006.

Expenditure differences for the various types of daycare services can be attributed to factors including but not limited to utilization rates, provider type, age of the child and whether services were provided on a full-time or part-time basis.

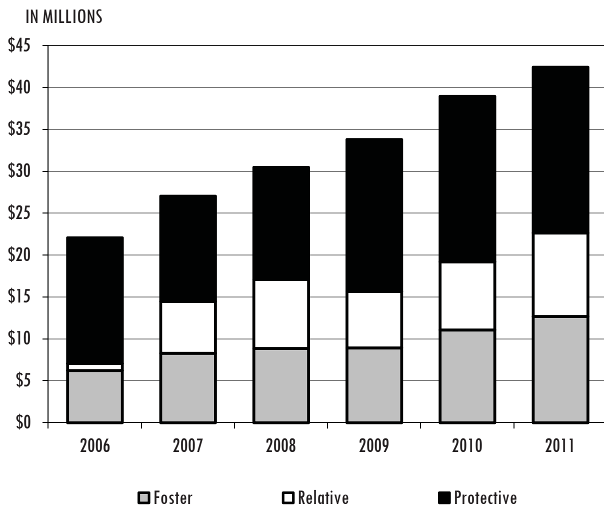
The Health and Human Services Commission forecasting team provides DFPS with projected CPS daycare needs based on current usage and eligibility policies for each type of daycare service. Expenditures for all types of daycare services are projected to increase by 8 percent in All Funds from fiscal years 2011 to 2015.

FIGURE 5
APPROPRIATED AND EXPENDED AMOUNTS FOR ALL DFPS-FUNDED DAYCARE, FISCAL YEARS 2006 TO 2011



SOURCE: Legislative Budget Board.

FIGURE 6
EXPENDED AMOUNTS FOR FOSTER, RELATIVE AND PROTECTIVE DAYCARE
FISCAL YEARS 2006 TO 2011



SOURCE: Legislative Budget Board.

ELIGIBILITY CRITERIA AND AUTHORIZATION PROCESS FOR DAYCARE SERVICES

As the demand for daycare services increases, DFPS should modify its eligibility and authorization processes to ensure that the demand for services is met in the most cost-effective manner.

Figure 7 shows the child and caregiver eligibility criteria for foster, relative and protective daycare services.

When a family seeks out DFPS-funded daycare services, they meet with a CPS caseworker who assesses funding availability, verifies the availability of space with the CCMS agency, and assesses the need and eligibility for daycare services. The CPS caseworker uses a case-management application, Information Management Protecting Adults and Children in Texas (IMPACT), to complete a daycare services request. The caseworker collects information pertaining to the caregiver and child when assessing the need and eligibility for daycare services. Information collected includes whether the request is an initial request, renewal or termination, and whether the child needs full, half-day or before or after school care.

To be eligible for foster daycare services, a child residing with a foster family or group home must be in the basic billing service level. A child in a basic billing service level must meet the following criteria: does not have any primary medical or rehabilitative needs that require intermittent interventions from a skilled caregiver; does not have the need for consistent and frequent attention, direction and assistance to help the child attain stabilization and connect appropriately with the child's environment; does not have any developmental or mental delays needing professionally directed self-help skills or; does not have a dependency on people or technology for accommodations managed by an appropriately constituted interdisciplinary team. According to the agency, foster children in higher service levels are not eligible for daycare services because caregivers are reimbursed a greater amount for taking care of children in higher service levels.

Special needs foster child daycare is available for children that are in the basic billing service level or in another service level but CPS has waived their status. Children must be age five or younger and be diagnosed with at least one development delay, and in need of therapeutic or habilitative child daycare. The child must have access to a center that can meet the child's needs. The foster parents must be employed full-time.

Before processing a request for foster or relative daycare services, CPS staff must verify that the caregiver attempted to access appropriate community-based services. These services include community programs such as Head Start, government-funded pre-kindergarten classes, and early education programs offered through local schools. The caseworker discusses with each caregiver what community resource they sought and why that resource was not available,

FIGURE 7
ELIGIBILITY CRITERIA FOR DAYCARE SERVICES, FISCAL YEAR 2011

TYPE OF DAYCARE	CHILD CRITERIA	CAREGIVER CRITERIA
Foster Daycare	The child must be in the managing conservatorship or legal custody of DFPS residing with a foster family or group home or be a child of a parent who is a minor and in foster care; be at a basic billing service level; not be in adoptive placement; be age 13 or younger.	The caregiver must verify that they have attempted to access daycare services in the community; all caregivers must be employed full time (40 hours/ week).
Relative Daycare	The child must be in the conservatorship of DFPS; be age 13 or younger, or age 18 or younger if the child has a developmental delay; not receiving adoption assistance.	The caregiver must verify that they have attempted to access daycare services in the community; all caregivers must be employed full time (40 hrs/ week); meet kinship caregiver definition; be formally approved by DFPS as a kinship caregiver; not be a licensed or verified foster home; be a resident of Texas.
Protective Daycare	The child must be age 12 or younger, or age 13 with a disability or be in DFPS conservatorship; part of open CPS case but not in paid substitute care; placed with parents, voluntary relative care, or in a kinship placement who are not verified foster parents which requires additional approval beyond the Regional daycare coordinator.	Approval through the CPS program administrator on a case-by-case basis.

Source: Texas Department of Family and Protective Services.

and documents this exchange on the IMPACT daycare request form. DFPS lacks a standardized and documented process to verify that DFPS daycare services are a provider of last resort for relative and foster caregivers. Recommendation 1 would amend the Texas Family Code to require DFPS to implement a standardized and documented process for verifying that kinship caregivers and foster parents have attempted to find appropriate services to care for a child through community services before the authorization or reauthorization of daycare services through DFPS. For example, CPS could require foster and relative caregivers to present a letter from a childcare center indicating that they are on a waiting list for services.

CPS staff requesting the service authorization for foster and relative daycare services must verify that the caregiver works 40 hours a week. CPS has reduced costs by approximately five percent by strengthening their verification of employment for foster parents and relative caregivers who work full-time. Acceptable verification of employment includes copies of the caregiver's pay stubs, an employer statement attesting to the employment of the caregiver for 40 hours per week, or a statement of self-employment income.

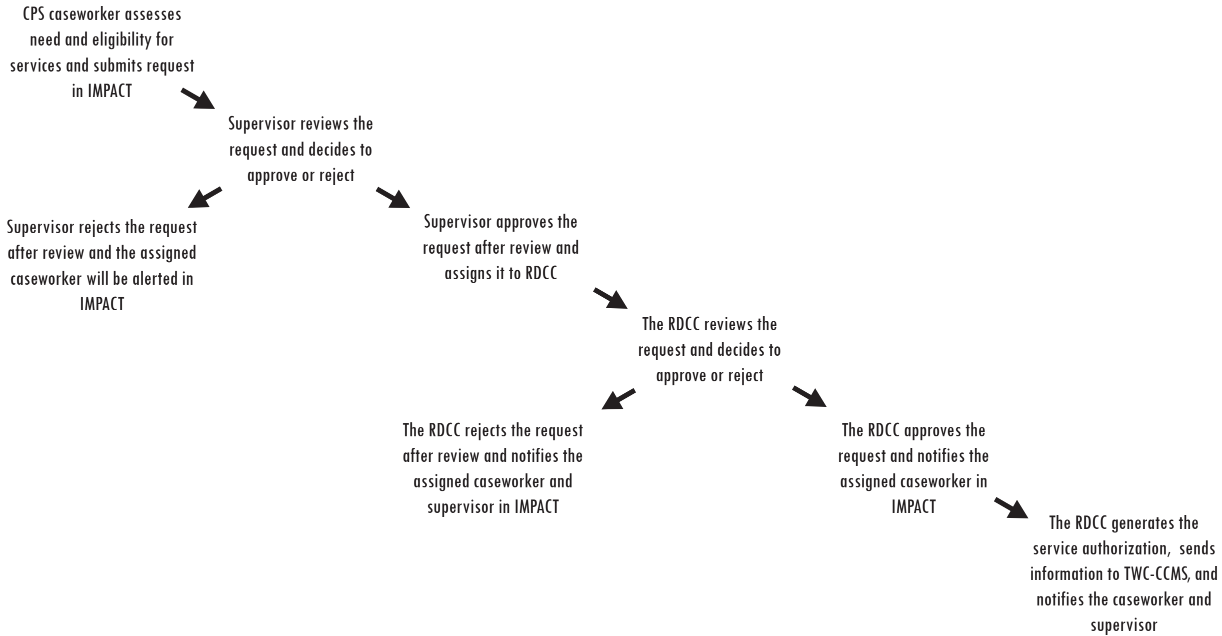
The IMPACT system automatically determines the type of daycare for which a child is eligible for, based on existing data in the system and additional information that the caseworker inputs into the system. There is a waiting period for all types of DFPS-funded daycare requests. The waiting period ensures that daycare is being authorized equitably, and that there is sufficient time to process daycare requests across the state. There is a 10-day waiting period for clients requesting foster daycare services for the first time. There is a 5- to 10-day waiting period for initial requests for relative and protective daycare. The average length of time between the initial request for DFPS-funded daycare services and receipt of services ranges from five to eight business days. **Figure 8** outlines the steps for processing a request for DFPS-funded daycare services using the IMPACT system.

Once daycare is authorized, DFPS staff maintain ongoing contact with the CCMS agency, daycare centers, and monitor any changes in the client's eligibility or circumstances. Initial receipt of daycare services is limited to two months for all types of daycare services. After two months of service, daycare services have to be reauthorized using the same process for the initial authorization for foster, relative or protective daycare.

For foster daycare services, subsequent reauthorizations may be approved for a maximum of six months. If at any time a child's billing service level changes from the basic service level, daycare is provided only through the term of the current authorization. The child's need must be re-examined before each subsequent authorization, and a supervisor must approve all authorizations for foster daycare services.

The reauthorization of relative daycare may be approved for a maximum of six months. **Figure 9** shows the time frames and approval for service authorizations for protective daycare.

FIGURE 8
STEPS FOR PROCESSING A DFPS-FUNDED DAYCARE SERVICES REQUEST, FISCAL YEAR 2011



Note: CPS = Child Protective Services; IMPACT = Information Management Protecting Adults and Children in Texas; RDCC = Regional Daycare Coordinator; TWC-CCMS = Texas Workforce Commission Child Care Management Services.
Source: Texas Department of Family and Protective Services.

FIGURE 9
TIME FRAMES AND APPROVAL FOR SERVICE AUTHORIZATIONS FOR PROTECTIVE DAYCARE FISCAL YEAR 2011

AUTHORIZATION	LENGTH OF SERVICE	FINAL APPROVER
Initial	2 months	Supervisor
1st Reauthorization	4 months	Supervisor
2nd Reauthorization	4 months	Program Director
3rd Reauthorization	4 months	Program Administrator
4th Reauthorization	4 months	Regional Director

Source: Texas Department of Family and Protective Services.

COST-CONTAINMENT STRATEGIES IN OTHER DAYCARE PROGRAMS

Other states and the Texas Workforce Commission (TWC) developed cost containment strategies to help ensure the cost effectiveness and efficiency of daycare services. Cost containment measures can also maximize the number of clients served by the program. TWC develops program policy and oversees the administration of TWC daycare services through 28 Local Workforce Development Boards. The local workforce development boards manage the cost and utilization of daycare services through the following types of strategies:

- setting income eligibility limits for childcare;
- maintaining waiting lists if there are insufficient funds to serve families seeking childcare services; and
- imposing cost-sharing requirements on clients receiving daycare services.

TWC exempts certain families from cost-sharing requirements such as clients participating in certain programs and clients who have a child or children receiving daycare services authorized and funded by DFPS. Cost sharing is established as a sliding fee scale based on family size, income and other factors deemed appropriate by each local board. Cost-sharing amounts are expressed as a percentage of either the federal poverty guidelines or the state median income.

Foster care redesign is an ongoing collaborative effort between DFPS and various stakeholders aimed at promoting positive outcomes for children, youth and families by improving the methods used for contracting and paying for services. Foster care redesign will result in a single source continuum contract (SSCC) for paid foster care and purchased services for children and youth in DFPS

Conservatorship and their families. According to the Request for Proposal for the SSCC, the entity chosen will receive a fixed number of foster daycare slots to be used for children and families who meet the appropriate eligibility criteria and will be required to coordinate with DFPS so that the agency can process payments for daycare to TWC. The SSCC may also elect to implement a sliding fee scale or other fees for purchased services such as foster daycare.

Similar to Texas, other states and territories provide childcare funding for eligible families using federal and state funds. In general, states provide childcare assistance for caregivers based on the following criteria:

- the caregiver needs to work, attend school or training;
- the caregiver's income is not greater than the income limit set by his/her state;
- the child is younger than age 13 and/or has special needs or is under court supervision and is younger than age 19.

Childcare policies in each state vary regarding income and other eligibility requirements. Other factors that vary from state to state include the application process, eligibility time limits, waiting list policies, copayment policies, health and safety requirements, and provider reimbursement and contract agreements. **Figure 10** shows strategies that other states have implemented to address budget constraints and the growing demand for childcare services.

The states listed in **Figure 10** provide childcare services for various populations including but not limited to eligible low-income families and children in protective services or foster care. Certain policies are waived for segments of the population or for individuals on a case-by-case basis.

Other strategies employed by states include: a 12-month limit on fee exemptions in California, a shorter reauthorization period of six months in Illinois, and reduced spending on professional developmental resources for childcare providers in Oklahoma.

ADDRESS THE INCREASED DEMAND AND COST FOR DFPS-FUNDED DAYCARE SERVICES

As discussed previously, DFPS projects that the monthly average number of children expected to receive foster, relative or protective daycare services will increase by 15 percent from fiscal years 2012 to 2015. Expenditures for all types of daycare services are projected to increase by 6 percent from fiscal years 2011 to 2015. As the demand for DFPS funded daycare services increases, it will be important to implement a standardized process to verify that DFPS-funded daycare services is a provider of last resort for children in foster and kinship care. There will also be a need to explore additional cost-containment strategies to ensure the cost effectiveness and efficiency of the program. Containing the cost of daycare services could potentially maximize the number of clients served by the program. DFPS could explore cost-containment practices including those employed by TWC and other states.

Recommendation 2 would include a rider in the introduced 2014–15 General Appropriations Bill to require DFPS to identify and implement appropriate cost-containment strategies for DFPS funded daycare services. Strategies that the agency could employ include but are not limited to the following options: (1) creating client priority groups

FIGURE 10
CHILDCARE COST CONTAINMENT STRATEGIES IMPLEMENTED IN OTHER STATES, 2012

STATE	COST-SHARING REQUIREMENTS	WAITING LISTS	PRIORITY GROUPS	DAYCARE SERVICE TIME LIMITS	INCREASE INCOME ELIGIBILITY LIMITS	MODIFY AGE LIMITS	OTHER
California	Yes	No	Yes	No	No	No	Yes
Florida	Yes	No	No	No	No	No	No
Illinois	Yes	No	No	Yes	Yes	No	Yes
Mississippi	Yes	Yes	Yes	No	No	No	No
Oklahoma	No	No	No	No	No	No	Yes
South Carolina	Yes	No	Yes	No	No	No	No
Texas	Yes	Yes	Yes	Yes	No	No	No

Source: Legislative Budget Board.

(2) instituting waiting lists based on client priority (3) implementing an income-based sliding fee scale for daycare services on a case-by-case basis (4) setting time limits on the receipt of services or cost-sharing exemptions.

Although DFPS collects data on the number of children and families who receive daycare services, it does not collect data on family size or income levels. Without this data, it is difficult to assess the population served and to determine the feasibility of implementing certain cost-containment strategies such as requiring a parent fee on a sliding fee scale basis. Limited data obtained from TWC on clients who received DFPS-funded daycare services revealed that their annual income levels ranged from $0 to $96,193 in calendar year 2011. Recommendation 3 would include a rider in the introduced 2014–15 General Appropriations Bill requiring DFPS to collect income and family size data on clients that receive relative or foster daycare services during the authorization and reauthorization process. This data could be used to implement cost-sharing requirements.

Recommendation 4 would include a rider in the introduced 2014–15 General Appropriations Bill to require DFPS to evaluate the impact of implemented cost-containment strategies for daycare service. The agency shall submit a report to the Governor's Office and the Legislative Budget Board by September 1, 2014.

FISCAL IMPACT OF THE RECOMMENDATIONS

There is no fiscal impact associated with Recommendations 1 to 4. It is assumed that the agency can implement the recommendations by using existing resources, and that strategies implemented would allow the agency to provide more children with daycare services.

The introduced 2014–15 General Appropriations Bill includes a rider to implement Recommendations 2, 3 and 4.

IMPROVE THE COST-EFFECTIVENESS OF FAMILY COST SHARE PROVISIONS IN THE EARLY CHILDHOOD INTERVENTION PROGRAM

High quality early childhood intervention services can change a child's development trajectory and improve outcomes for children, families, and communities. The Texas Department of Assistive and Rehabilitative Services administers the Early Childhood Intervention program that serves families with children from birth to 36 months who have developmental delays or diagnosed physical or mental conditions with high probabilities of resulting in developmental delays. The agency contracts with 51 local agencies throughout Texas to provide early childhood intervention services. Texas receives federal grant funding for the program, therefore the agency must comply with requirements prescribed in the federal Individuals with Disabilities Education Act.

The agency implemented family cost-share provisions in the Early Childhood Intervention program in 2004. The cost-share amount is determined by a sliding fee scale based on family size and adjusted gross income after allowable deductions. The family cost share provision generates revenue that funds less than 1 percent of the overall program budget. Due to agency data limitations, the cost effectiveness of existing family cost share provisions or any proposed changes that might generate additional revenue is unknown. To increase the amount of family cost-share revenue collected in the Early Childhood Intervention program, the state should take steps to improve the cost-effectiveness of family cost-share provisions, including improving data collection, evaluating the cost-effectiveness of existing provisions, and implementing changes to improve cost-effectiveness.

FACTS AND FINDINGS

- ♦ From fiscal years 2011 to 2012, total All Funds spending on Texas Early Childhood Intervention services decreased from $205.1 million to $179.3 million, a 12.6 percent decrease. The spending reduction was primarily due to only a partial replacement of reduced federal funding and thus, a reduction in funds appropriated to the Department of Assistive and Rehabilitative Services for the Early Childhood Intervention program for the 2012–13 biennium.
- ♦ To mitigate funding reductions in the Early Childhood Intervention program, the Department of Assistive and Rehabilitative Services implemented cost containment strategies, including narrowing eligibility criteria and strengthening family cost-share provisions.
- ♦ The estimated amount of family cost-share fees collected for Early Childhood Intervention services provided during fiscal year 2012 totaled $945,959, or 0.5 percent of total spending.
- ♦ From fiscal year 2011 to fiscal year 2012, the average number of children and families served each month decreased from 30,492 to 25,035. The estimated average number of children and families to be served in fiscal year 2013 is 25,977.
- ♦ There are families enrolled in the Early Childhood Intervention program in higher income brackets receiving more than the average number of service hours that could potentially be subject to greater fees under a revised family cost-share structure.

CONCERN

- ♦ The family cost share provision in the Early Childhood Intervention program generates revenue that funds less than 1 percent of the overall program budget. The state cannot determine the cost effectiveness of existing family cost share provisions or any proposed changes that might generate additional revenue because the Department of Assistive and Rehabilitative Services does not collect certain data, including the cost to administer family cost share provisions and adjusted gross income.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Amend statute to direct the Department of Assistive and Rehabilitative Services to collect data necessary to allow the agency to determine the cost-effectiveness of both existing family cost share provisions in the Early Childhood Intervention program and any proposed changes to these provisions, including data on administrative costs and adjusted gross income.
- ♦ **Recommendation 2:** Amend statute to direct the Department of Assistive and Rehabilitative

Services to evaluate the cost-effectiveness of existing family cost share provisions in the Early Childhood Intervention program and to implement changes to these provisions that would result in a net increase in family cost-share revenue after deducting the cost to administer family cost-share provisions.

- **Recommendation 3:** Include a rider in the introduced 2014–15 General Appropriations Bill to require the Department of Assistive and Rehabilitative Services to submit a report on changes implemented to improve the cost-effectiveness of family cost share provisions in the Early Childhood Intervention program to the Legislative Budget Board and the Office of the Governor by December 1, 2014.

DISCUSSION

The Individuals with Disabilities Education Act (IDEA) is a federal law that authorizes states to operate early childhood intervention programs. IDEA governs how states and public agencies provide early intervention, special education and related services to children with disabilities. Under Part C of IDEA, states may apply for grants that can be used to maintain and implement a statewide system to provide early intervention services to infants and toddlers with disabilities from birth to age three and their families. Early intervention programs receiving grants under IDEA must comply with federal requirements. Children and youth from age 3 to 21 receive special education and related services under IDEA Part B through their local school district.

In Texas, the Department of Assistive and Rehabilitative Services (DARS) administers the Early Childhood Intervention (ECI) program. DARS contracts with 51 local agencies throughout Texas to provide ECI services. Every Texas county is served by one or more local ECI programs. ECI providers include local community centers, local independent school districts, regional education service centers, and private non-profit organizations.

ECI serves families with children from birth to 36 months who have developmental delays or diagnosed physical or mental conditions with high probabilities of resulting in developmental delays. As shown in **Figure 1**, a child is determined eligible for ECI services when they have a significant developmental delay, a qualifying medically diagnosed condition, or a documented auditory or visual impairment.

Local ECI providers evaluate and assess children referred to ECI to determine eligibility and the need for services. As of September 2011, DARS requires the use of one evaluation tool, the Batelle Developmental Inventory (BDI-2) for eligibility determination. This is a change from the previous standard that allowed local ECI contractors to use one of four designated tools, one of which was the BDI-2. If eligible, families and professionals work together to develop the Individual Family Service Plan (IFSP). The IFSP is a written plan for a child's and family's services based on their individual needs. ECI uses an interdisciplinary team of licensed or credentialed professionals and individualizes services to the needs of each child and family. The team includes early intervention specialists, speech and language pathologists, physical and occupational therapists and assistants, psychologists, registered nurses, dietitians, social workers, and counselors.

FIGURE 1
TEXAS EARLY CHILDHOOD INTERVENTION PROGRAM ELIGIBILITY CRITERIA, FISCAL YEAR 2012

ELIGIBILITY CATEGORY	DESCRIPTION	*PERCENTAGE OF ENROLLED CHILDREN
Developmental delay	A documented delay on a standardized testing tool of at least 25 % in one or more of the following developmental areas: communication, cognitive, gross motor, fine motor, social-emotional, or adaptive/self-help skills.	77%
Medically diagnosed condition	A medically diagnosed condition with a high probability of resulting in a developmental delay. The child must also demonstrate a need for services. The diagnosis must be on the DARS ECI list of qualifying medical diagnoses and medical records must be provided to confirm the diagnosis. Of those with a medically diagnosed condition, the most common diagnosis is chromosomal anomalies (e.g., Down Syndrome).	20%
Auditory or visual impairment	An auditory or visual impairment as defined by the Texas Education Agency. The child must be diagnosed by the appropriate specialist (e.g., otologist, audiologist, ophthalmologist, or optometrist) and must meet criteria to qualify for services through the local school district.	3%

*Estimated.
Source: Legislative Budget Board.

ECI services are provided in settings that are familiar to the child and family, such as the child's home or day care center. These services include:

- occupational therapy;
- physical therapy;
- speech language therapy;
- specialized skills training;
- family education and training;
- nutrition services;
- nursing services;
- assistive technology;
- behavioral intervention;
- psychological services;
- services for children with auditory and visual impairment;
- service coordination;
- social work; and
- counseling.

POTENTIAL BENEFITS OF EARLY CHILDHOOD INTERVENTION SERVICES

According to the Center on the Developing Child at Harvard University, neural connections, which create the foundation for learning, behavior and health, are most flexible or "plastic" during the first three years of life. The brain's capacity for change decreases with age. Early plasticity means it is easier and more effective to influence a baby's developing brain architecture than to rewire parts of its circuitry in the adult years. The emotional and physical health, social skills, and cognitive-linguistic capacities that emerge in the early years are all important prerequisites for success in school and later in the workplace and community.

High-quality early intervention services can change a child's development trajectory and improve outcomes for children, families, and communities. The purpose of intervening is to improve the child's rate of skill acquisition. Services to young children who have or are at risk for developmental delays have been shown to improve outcomes across developmental domains, including health, language and communication, cognitive development and social/emotional development. Benefits to society include reducing educational costs by decreasing the need for special education services as children with disabilities reach school age.

Early intervention services help many children develop skills at a level equal to their peers by age three. For children with severe disabilities, progress may be slower and children with degenerative conditions may even lose skills, but services can help to slow or reduce the impact of their disabilities. According to the final 2007 report of the National Early Intervention Longitudinal Study (NEILS), overall outcomes for infants and toddlers participating in IDEA Part C programs included increased motor, social, and cognitive functioning; the acquisition of age-appropriate skills; and reduced negative impacts of their disabilities. Furthermore, NEILS found that 46 percent of children who had received IDEA Part C services and been at risk of needing special education services did not need special education at kindergarten age. These children were performing just as well in early reading and mathematics as the general population of children in kindergarten.

The U.S. Department of Education's Office of Special Education Programs requires all states to submit outcome data for children receiving IDEA Part C services. As shown in **Figure 2**, national child outcome data collected by states showed that between 68 percent and 73 percent of the children receiving IDEA Part C services demonstrated greater than expected growth across three outcome categories: positive social relationships, acquisition and use of knowledge and skills, and use of appropriate behaviors to meet needs (e.g., self-care). Children whose growth was greater than expected means that their growth rate with intervention was greater than their growth rate before intervention. Furthermore, many children exited IDEA Part C functioning within age expectations. For example, 55 percent of the children receiving IDEA Part C services exited the program functioning within age expectations in the knowledge and skills outcome category. National data is based on 39 states that reported data for IDEA Part C services that met quality criteria as determined by the U.S. Department of Education's Office of Special Education Programs. States are at various stages in implementing procedures for measuring child outcomes data, and not all states were able to report data that met quality criteria for fiscal year 2011. Texas outcome data for children receiving IDEA Part C services is comparable to national outcome data.

FIGURE 2
OUTCOME DATA FOR IDEA PART C SERVICES, FISCAL YEAR 2011

	SOCIAL RELATIONSHIPS		KNOWLEDGE AND SKILLS		ACTION TO MEET NEEDS	
OUTCOME	TEXAS	NATIONAL	TEXAS	NATIONAL	TEXAS	NATIONAL
Showed greater than expected growth	71%	68%	76%	73%	75%	73%
Exited the program within age expectations	64%	61%	56%	55%	63%	59%

NOTE: National data is based on 39 states that reported data for IDEA Part C services that met quality criteria as determined by the U.S. Department of Education's Office of Special Education Programs. Because states define fiscal years differently, there is variation among the states in what months are included in the data reported for fiscal year 2011.
SOURCE: U.S. Department of Education's Office of Special Education Programs.

EARLY CHILDHOOD INTERVENTION PROGRAM SPENDING AND COST CONTAINMENT STRATEGIES

Texas ECI services are funded by several sources, including state General Revenue Funds, federal IDEA funds, Temporary Assistance for Needy Families (TANF) block grant, Medicaid, Foundation School Funds, private insurance, family cost-share contributions, and local revenue. **Figure 3** shows total All Funds spending on Texas ECI services provided during fiscal years 2011 and 2012 by method of finance. From fiscal years 2011 to 2012, total spending on Texas ECI services decreased from $205.1 million to $179.3 million, a 12.6 percent decrease.

Local ECI providers obtain funding to deliver services in the following ways:

- ECI providers receive reimbursement from DARS for allowable costs per their approved contract and budget. Allowable ECI costs are negotiated and agreed to in an annual budget and monitored by DARS. The methods of finance for reimbursement provided by DARS include a match of General Revenue Funds for Medicaid Administrative Claiming (MAC), IDEA, TANF, and Foundation School Funds. These funds are appropriated to DARS through the legislative process.
- ECI providers bill the Texas Medicaid and Healthcare Partnership (TMHP) or Medicaid managed care organizations for ECI services paid for by Medicaid. ACS State Healthcare LLC, under contract with the Texas Health and Human Services Commission (HHSC), administers claims processing for Texas Medicaid with a team of subcontractors under the name of TMHP. Depending on the type of service, TMHP receives funds from either DARS or HHSC. Medicaid managed care organizations receive a premium payment from HHSC to deliver all medically necessary services to enrolled clients, including certain ECI services. The MAC match (General Revenue Funds) is paid through the ECI contract with the federal share paid separately by DARS. These funds, paid to TMHP, Medicaid managed care organizations, or ECI providers, are appropriated to DARS and HHSC through the legislative process.
- ECI providers bill private insurance. Private insurance billing is outside the state appropriation process.
- ECI providers bill families for the family cost-share amounts. Collection of family cost-share amounts is outside the state appropriation process.
- ECI providers collect additional local revenue through grant applications and fundraising activities. Collection of additional local revenue is outside the state appropriation process.

The spending reduction shown in **Figure 3** was primarily due to only a partial replacement of reduced federal funding and thus, a reduction in funds appropriated to DARS for the ECI program for the 2012–13 biennium. To mitigate funding reductions in the ECI program, DARS narrowed eligibility criteria and strengthened cost-share provisions to contain cost.

As shown in **Figure 1,** there are three eligibility categories under which a child may qualify for ECI services – significant developmental delay, a qualifying medically diagnosed condition, or a documented auditory or visual impairment. DARS increased the amount of developmental delay that a child must have to qualify for ECI services from approximately 15 percent in one or more areas to 25 percent. For example, a child who is 16 months of age must now have a developmental delay of four months or more to be eligible. There were no changes made to the other two eligibility categories. The new eligibility criterion applies to children who enrolled in the ECI program on or after September 1, 2011. The required amount of developmental delay for

FIGURE 3
TEXAS EARLY CHILDHOOD INTERVENTION PROGRAM SPENDING BY METHOD OF FINANCE
FISCAL YEARS 2011 AND 2012

METHOD OF FINANCE	2011	PERCENTAGE OF TOTAL	2012[1]	PERCENTAGE OF TOTAL
General Revenue Funds	$1,051,019	0.5%	$1,273,358	0.7%
General Revenue Match/Certified as Match for Medicaid	34,396,921	16.8	25,625,356	14.3
Total General Revenue Funds	**$35,447,940**	**17.3%**	**$26,898,714**	**15.0%**
IDEA Part C Stimulus	$4,132,177	2.0%	$0	-
Medicaid Stimulus	5,473,611	2.7	0	-
Total Stimulus	**$9,605,788**	**4.7%**	$0	-
IDEA Part C	$44,453,990	21.7%	$35,906,170	20.0%
IDEA Part B	5,131,125	2.5	5,131,125	2.9
TANF	11,783,576	5.7	16,102,792	9.0
Medicaid	63,489,960	31.0	38,096,763	21.3
Total Federal Funds	**$124,858,651**	**60.9%**	**$95,236,850**	**53.1%**
Foundation School Funds	$16,498,102	8.0%	$16,498,102	9.2%
Private Insurance (CHIP, Tricare, Other)	5,666,228	2.8	7,358,433	4.1
Family Cost Share	917,763	0.4	945,959	0.5
Local Revenue	5,620,896	2.7	6,175,657	3.4
Comprehensive Care Program[2]	6,479,314	3.2	26,149,943	14.6
Total Other Funds	**$35,182,303**	**17.2%**	**$57,128,094**	**31.9%**
Total Spending	**$205,094,682**	**100.0%**	**$179,263,658**	**100.0%**

[1]2012 data is preliminary and may change after the agency completes its review of ECI contractor data.
[2]The Comprehensive Care Program is funded with state and federal Medicaid funds.
NOTE: Spending on Medicaid-funded therapies provided during fiscal year 2011 is included in General Revenue Funds and Federal Funds. Spending on Medicaid-funded therapies provided during fiscal year 2012 is included in the Comprehensive Care Program category under Other Funds.
SOURCE: Texas Department of Assistive and Rehabilitative Services.

children who had their eligibility re-determined on or after September 1, 2011 is 15 percent in one or more areas.

DARS implemented family cost-share provisions in the ECI program in 2004. In fiscal year 2012, DARS changed family cost-share provisions. Key changes include requiring lower income families to participate in cost-sharing, expanding the DARS ECI sliding fee scale; further incentivizing families to consent for ECI to bill their private and public insurance; and requiring that ECI providers bill families for insurance deductibles, co-pays, and coinsurance up to the family cost share amount. **Figure 4** provides additional detail on the key changes made to family cost-share provisions during fiscal year 2012.

Cost containment strategies have decreased the number of children and families served by the ECI program. As shown in **Figure 5**, from fiscal year 2011 to fiscal year 2012, the average number of children and families served each month decreased from 30,492 to 25,035. The estimated average number of children and families to be served in fiscal year 2013 is 25,977.

IMPROVE THE COST-EFFECTIVENESS OF FAMILY COST SHARE PROVISIONS IN THE EARLY CHILDHOOD INTERVENTION PROGRAM

Pursuant to current family cost-share provisions in the ECI program, families who have the ability to pay are asked to pay a portion of the cost of certain services. Federal regulations require that DARS define a family's inability to pay for any ECI services. If the parent or family meets the state's definition of inability to pay, the child with a disability must be provided all ECI services at no cost. DARS defines an inability to pay as a family with adjusted gross income at or below 100 percent of the Federal Poverty Level who does not have public or private insurance. Other families who do not meet this definition are determined to have an ability to

FIGURE 4
KEY CHANGES TO FAMILY COST-SHARE PROVISIONS IN THE TEXAS EARLY CHILDHOOD INTERVENTION PROGRAM
FISCAL YEARS 2011 AND 2012

	FISCAL YEAR 2012	
FISCAL YEAR 2011	SEPTEMBER 1, 2011	JULY 1, 2012
Families were assigned a cost share of $0 if their adjusted gross income was at or below 250% of the Federal Poverty Level.	Families were assigned a cost share of $0 if their adjusted gross income was at or below 200% of the Federal Poverty Level.	Families were assigned a cost share of $0 if their adjusted gross income was at or below 100% of the Federal Poverty Level.
The DARS ECI sliding fee scale ranged from $20 to $150.	The DARS ECI sliding fee scale ranged from $10 to $175.	The DARS ECI sliding fee scale ranged from $3 to $175.
Families who refused to provide consent for ECI to bill their private insurance were assigned a cost share that was based on their family size and adjusted gross income.	Families who refused to provide consent for ECI to bill their private insurance were assigned the highest family cost share amount on the DARS ECI sliding fee scale.	Families who refused to provide consent for ECI to bill their private or public insurance were assigned the highest family cost share amount on the DARS ECI sliding fee scale.
Family cost share rules did not address insurance co-pays, deductibles or coinsurance.	ECI providers must bill families for insurance deductibles up to the family cost share amount for the month IFSP services are delivered.	ECI providers must collect co-pays, coinsurance and deductibles up to the family cost share amount for the month IFSP services are delivered.

Note: ECI= Early Childhood Intervention program.
Source: Legislative Budget Board.

FIGURE 5
TEXAS EARLY CHILDHOOD INTERVENTION PROGRAM
AVERAGE MONTHLY NUMBER OF CHILDREN SERVED
FISCAL YEARS 2011 AND 2012

FISCAL YEAR	AVERAGE MONTHLY NUMBER OF CHILDREN
2011	30,492
2012	25,035
Percentage Change	(17.9%)

Source: Texas Department of Assistive and Rehabilitative Services.

pay and their monthly cost-share amount is determined by a sliding fee scale based on family size and adjusted gross income after allowable deductions. **Figure 6** shows the current ECI family cost-share sliding scale for services subject to family cost-share provisions. IDEA requires that the following services are provided at no cost regardless of income:

- evaluations and assessments;
- development of the IFSP;
- case management;
- translation or interpreter services;
- services for children with auditory and visual impairments who are eligible for services from ECI and local school districts; and
- services for children in foster care or in conservatorship of the state.

FIGURE 6
TEXAS EARLY CHILDHOOD INTERVENTION PROGRAM
FAMILY COST SHARE SLIDING SCALE
EFFECTIVE JULY 1, 2012

FEDERAL POVERTY LEVEL PERCENTAGE CATEGORY	MAXIMUM MONTHLY FEE
Less than or equal to 100%	$0
Greater than 100% to 150%	$3
Greater than 150% to 200%	$5
Greater than 200% to 250%	$10
Greater than 250% to 350%	$20
Greater than 350% to 450%	$55
Greater than 450% to 550%	$85
Greater than 550% to 650%	$115
Greater than 650% to 750%	$145
Greater than 750%	$175

Source: Texas Department of Assistive and Rehabilitative Services.

DARS must comply with IDEA and federal regulations when establishing family cost-share provisions. For example, the state cannot charge families more than the actual cost of the ECI service minus any amount received from other sources for payment for that service. The state must also ensure that a parent or family's inability to pay does not result in delay or denial of services.

Family cost-share provisions are established in DARS' agency rules. However, each ECI provider implements the family cost-share system at the local level. Families are evaluated to

determine their ability to pay when the child enrolls in the program, at the annual eligibility redetermination, or more frequently by parent request. Each ECI provider is responsible for collecting cost-share fees from families and maintains their own financial billing and reporting system.

The family cost share provision in the ECI program generates revenue that funds less than 1 percent of the overall ECI program budget. The estimated amount of family cost-share fees collected for ECI services provided during fiscal year 2012 totaled $945,959, or 0.5 percent of total spending. The state cannot determine the cost effectiveness of existing family cost share provisions or any proposed changes that might generate additional revenue because DARS does not collect certain data, including the cost to administer family cost share provisions and adjusted gross income.

Recommendation 1 would amend the Texas Human Resources Code to direct DARS to collect data necessary to allow the agency to determine the cost-effectiveness of both existing family cost share provisions in the ECI program and any proposed changes to these provisions, including data on administrative costs and adjusted gross income.

During interviews, some ECI providers anecdotally reported to Legislative Budget Board (LBB) staff that the cost to administer family cost-share provisions is greater than the amount of family cost-share revenue collected. However, DARS does not maintain data on the cost to administer family cost share provisions because ECI providers do not submit budget information based on activities, such as administering the family cost-share system. As a result, allowable costs in budget categories (e.g., salaries, supplies, rent) are not broken down between costs to support the system to bill and collect family cost-share fees and the costs for other activities such as other administrative functions (e.g., data entry) or direct services. However, DARS should develop an approach or methodology to calculate the cost to administer family cost share provisions. For example, activity-based costing is an accounting method that could be used that assigns costs to activities, products or services based on the resources they consume. Alternatively, DARS could request ECI providers to submit their own estimates of the cost to administer family cost share provisions based on guidelines developed by DARS.

Currently, ECI providers use their own individual financial billing and reporting systems to manage family cost-share collections. TKIDS, the ECI data system used primarily to collect and maintain information about ECI services provided to enrolled children, is not used by ECI providers to manage family cost-share collections. While ECI providers do enter family size, gross income, and insurance status into TKIDS, the data system is not programmed to accept adjusted gross income. However, DARS could program TKIDS to allow ECI providers to enter data on adjusted gross income into TKIDS as well as the local system.

Recommendation 2 would amend the Texas Human Resources Code to direct DARS to evaluate the cost-effectiveness of existing family cost share provisions in the ECI program and to implement changes to these provisions that would result in a net increase in family cost-share revenue after deducting the cost to administer family cost-share provisions. DARS could use existing data and new data obtained by implementing Recommendation 1 to complete its evaluation of the current family cost-share system and to determine which changes would be cost-effective.

Family cost-share provisions in the Texas ECI program do not tie the amount a family pays to the amount of service received. DARS should consider implementing changes to family cost-share provisions that would tie the amount a family pays to the amount of service they received. The total amount paid by a family could still be capped based on family size and adjusted gross income, but DARS should consider increasing the maximum amount families in the higher income brackets pay. These two changes would allow higher income families who receive more than the average amount of service to pay a greater fee than is allowed by the current system. As shown in **Figure 7**, there are families in higher income brackets receiving more than the average number of service hours, who could be subject to greater fees under a revised structure.

In some states, the amount a family pays towards certain ECI services is based directly on the amount of service they received. As shown in **Figure 8**, there are at least five other states where the amount a family pays is based on the amount of service received. For example, in New Jersey, families pay a fee per service hour (i.e., hourly copay) and in North Carolina, families pay a percentage of the cost of services. The states listed in **Figure 8** have also structured their cost-share system in a way that allows higher income families to pay a larger amount than Texas allows. For example, the maximum monthly cost-share for Texas families in the highest income bracket is $175. In contrast, the maximum monthly cost-share for New Jersey families in the highest income bracket is $1,403 plus 0.375 percent of the family's incremental annual income above $380,000.

FIGURE 7
TEXAS EARLY CHILDHOOD INTERVENTION PROGRAM: MONTHLY DELIVERED SERVICE HOURS BY FEDERAL POVERTY LEVEL PERCENTAGE CATEGORY, MARCH 2012

FEDERAL POVERTY LEVEL PERCENTAGE CATEGORY[1]	TOTAL CASES	PERCENTAGE OF TOTAL CASES	TOTAL DELIVERED HOURS	AVERAGE DELIVERED HOURS	MINIMUM DELIVERED HOURS BY CASE	MAXIMUM DELIVERED HOURS BY CASE
Less than 100%	11,496	54.43	33,918	2.95	0.25	19.75
100% to 132%	2,094	9.91	6,338	3.03	0.25	16.00
133% to 149%	568	2.69	1,747	3.08	0.33	21.33
150% to 184%	1,161	5.50	3,646	3.14	0.25	22.00
185% to 199%	504	2.39	1,668	3.31	0.25	22.00
200% to 249%	1,126	5.33	3,629	3.22	0.50	17.00
250% to 299%	923	4.37	3,077	3.33	0.50	18.50
300% to 349%	752	3.56	2,523	3.36	0.25	20.13
350% to 399%	508	2.41	1,772	3.49	0.25	16.55
400% to 449%	442	2.09	1,554	3.52	0.25	13.42
450% to 499%	262	1.24	905	3.45	0.75	12.27
500% to 549%	242	1.15	849	3.51	0.50	16.17
550% to 599%	148	0.70	491	3.32	0.50	12.00
600% to 649%	115	0.54	379	3.30	0.75	10.53
650% to 699%	92	0.44	334	3.63	0.75	9.92
700% to 749%	94	0.45	315	3.36	0.75	8.67
750% to 799%	63	0.30	228	3.63	0.75	9.92
800% +	219	1.04	782	3.57	0.50	12.75
Pending[2]	310	1.47	931	3.00	0.50	11.08
Total	**21,119**	**100.00**	**65,094**	**3.08**	**0.25**	**22.00**

[1]The number of families in each federal poverty level percentage category is based on gross income because TKIDS, the ECI data system, does not capture adjusted gross income. DARS ECI family cost-share system is based on adjusted gross income.
[2]The data field for gross income was blank for cases in the pending row.
Note: Data is based only on cases where the child received at least one service to which the family cost share applies.
Source: Texas Department of Assistive and Rehabilitative Services.

Recommendation 3 would include a rider in the introduced 2014–15 General Appropriations Bill to require DARS to submit a report on changes implemented to improve the cost-effectiveness of family cost share provisions in the ECI program to the LBB and the Office of the Governor by December 1, 2014.

FISCAL IMPACT OF THE RECOMMENDATIONS

The recommendations direct DARS to take steps to evaluate and improve the cost-effectiveness of family cost-share provisions in the ECI program. It is estimated that the recommendations would have no significant fiscal impact because they could be implemented using existing agency resources. To the extent that DARS implements changes to family cost-share provisions that improve their cost-effectiveness, the ECI program could potentially collect additional cost-share revenue.

Recommendation 1 directs DARS to collect data necessary to allow the agency to determine the cost-effectiveness of both existing family cost share provisions in the ECI program and any proposed changes to these provisions, including data on administrative costs and adjusted gross income. This recommendation could be implemented using existing agency resources. According to DARS, the agency could add a field to TKIDS to allow ECI providers to enter data on adjusted gross income without incurring additional costs. DARS does believe there would be additional administrative costs to ECI providers for data entry in TKIDS. However, any additional administrative cost incurred by ECI providers should be offset by increased cost-share revenue generated by

FIGURE 8
OVERVIEW OF EARLY CHILDHOOD INTERVENTION FAMILY COST-SHARE SYSTEM FEATURES IN TEXAS AND SELECTED OTHER STATES, FISCAL YEAR 2013

STATE	BASELINE INCOME AS PERCENTAGE OF FPL* SUBJECT TO COST-SHARE	METHOD	FEE RANGE	MAXIMUM MONTHLY COST-SHARE RANGE
Texas	More than 100%	Monthly Fee	$3 to $175	$3 to $175
Alaska	115%	Percentage of cost per service hour	10% to 100%	No maximum
Arizona	200% or more	Percentage of cost of services	15% to 100%	No maximum
Indiana	More than 250%	Fee per 15-minute service unit	$0.75 to $25	$48 to $1,600
New Jersey	300% or more	Fee per service hour	$2 to actual cost of service	$148 to $1,403 plus 0.375% of the family's incremental annual income above $380,000
North Carolina	More than 200%	Percentage of cost of services	20% to 100% of service costs or 5% of adjusted gross income	5% of adjusted gross income

*Federal Poverty Level.
Source: Legislative Budget Board.

changes made by DARS to improve the cost-effectiveness of family cost-share provisions as directed in Recommendation 2.

Recommendation 2 directs DARS to evaluate the cost-effectiveness of existing family cost share provisions in the ECI program and to implement changes to these provisions that would result in a net increase in family cost-share revenue after deducting the cost to administer family cost-share provisions. The recommendation is intended to result in changes to ECI family cost-share provisions that improve their cost-effectiveness and increase the net amount of cost-share revenue collected. Additional cost-share revenue could potentially be used to serve additional children by expanding eligibility criteria or providing additional service hours. The evaluation of existing family cost share provisions as well as implementation of changes to improve cost-effectiveness could be implemented using existing agency resources.

Recommendation 3 directs DARS to submit a report on changes implemented to improve the cost-effectiveness of family cost share provisions in the ECI program to the LBB and the Office of the Governor by December 1, 2014. This recommendation could be implemented using existing resources.

The introduced 2014–15 General Appropriations Bill includes a rider to implement Recommendation 3.

ESTABLISH A PERMANENT MECHANISM TO REVIEW SENTENCING POLICIES AND CONTROL CRIMINAL JUSTICE COSTS

During the past two biennia, Texas has seen annual declines in the prison population. This decrease is due in part to the treatment programs that were implemented in fiscal years 2005 and 2007 to reduce the rate of growth in the prison population. While this strategy has helped mitigate the growth in the state prison population, Texas lacks a comprehensive process to monitor and assess the impact of practices, policies, and existing laws on offender populations and the correctional resources of the state. Establishing a sentencing commission to review Texas sentencing laws and recalibrate county and state fiscal and housing responsibilities for offenders would improve criminal justice system efficiency and reduce state costs.

FACTS AND FINDINGS

- ♦ From 1971 to 1993, major revisions of the Texas Penal Code occurred nearly every decade. During that time, the State Bar Committee on Revision of the Penal Code was formed to consolidate, simplify, and modernize the code.
- ♦ The last commission to review the Texas Penal Code comprehensively met from fiscal years 1991 to 1993. The Punishment Standards Commission (PSC) engaged in a thorough review of the penal code, which removed some obsolete offenses and adjusted the punishment for other offenses.
- ♦ The criminal sentencing data available to Legislative Budget Board staff to make cost and population projections is 20 years old. It does not provide victim information, prior criminal history or offense details (such as drug types, amount of drugs purchased or sold, or value of stolen goods).
- ♦ For the 2012–13 biennium, Texas budgeted approximately $2.5 billion per fiscal year to incarcerate offenders. At 6.2 percent of the state's General Revenue Fund expenditures, adult corrections accounts for a significant portion of the Texas budget.
- ♦ As of April 2012, the federal government, the District of Columbia, and 23 states have sentencing commissions or similar entities charged with reviewing sentencing practices, controlling rising corrections budgets, and simplifying and modernizing laws.

CONCERNS

- ♦ Although the Texas Legislature modifies provisions of the Texas Penal Code every biennium, the last comprehensive review of the code occurred 20 years ago. It resulted in removal of some obsolete offenses and adjustments in punishment for other offenses. However, some of the Punishment Standards Commission's recommendations resulted in longer sentences and longer probation terms for some offenses. Longer sentences contribute to growing system costs, and there has been no thorough review of sentencing laws since then to adjust for these increased costs.
- ♦ The last statewide study that included detailed data on felony convictions occurred in 1993. The lack of current arrest and sentencing data at the state level hinders the state's ability to assess the effect of proposed changes in sentencing policy.
- ♦ Sentencing policies affect sentence lengths and prison admissions, which affect prison populations. Any changes in these factors can have a significant effect on available criminal justice resources. Despite modest prison population decreases, costs to incarcerate offenders continue to increase steadily from $2.0 billion to $2.5 billion from fiscal years 2007 to 2013.
- ♦ Recommendations made by sentencing commissions in other states have resulted in significant savings and prison population decreases. Texas lacks a process to assess sentencing practices and may be foregoing savings and other efficiencies that may be achieved through sentencing reform.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Amend statute to establish a sentencing commission to review Texas sentencing laws comprehensively to align penalties with offenses, modernize laws, and study statewide sentencing dynamics every ten years.
- ♦ **Recommendation 2:** Include a contingency rider in the 2014–15 General Appropriations Bill to appropriate $1.15 million in General Revenue Funds

to operate a sentencing commission and implement a statewide sentencing dynamics study.

DISCUSSION

The last commission to review the Texas Penal Code comprehensively met from fiscal years 1991 to 1993. The Punishment Standards Commission (PSC) engaged in a thorough review of the penal code, which removed some obsolete offenses and adjusted the punishment for other offenses. However, some of the recommendations focused on ensuring that the amount of time offenders actually served was not significantly less than the prison term imposed in court at sentencing. Some recommendations resulted in longer sentences and probation terms. Longer sentences contribute to growing system costs, and there has not been another commission to control for unintended consequences.

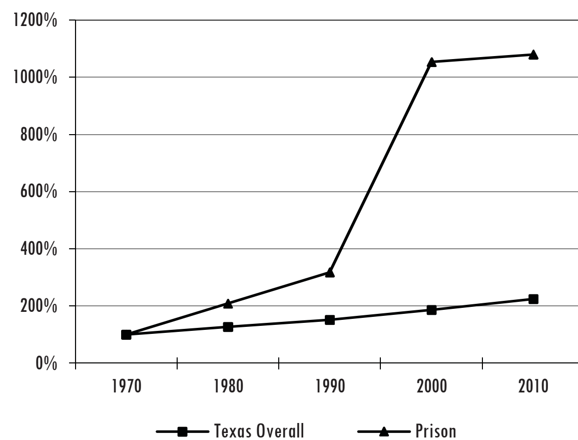
According to the Vera Institute of Justice, growth in prison populations during the past several decades is not due to increased crime, but to sentencing policies that have increased the number of offenses resulting in incarceration, the length of sentences, and the length of probation. A report released in June 2012 by Pew's Public Safety Performance Project (the project) showed that Texas offenders released in 2009 served an average of 32 percent longer than those released in 1990 did. Based on this percentage, the average offender served eight months more than an offender released in 1990 did. According to the project, these extended sentences cost Texas an additional $14,682 per offender, for a total cost of $602.1 million for all offenders released in fiscal year 2009.

Longer sentences and probation terms, a steady but increasing number of prison admissions, and until recently, low parole approval rates, are all factors that contribute to the high cost of criminal justice in Texas. Although there is no prison population "crisis" like in the 1990s and "tough on crime" policies have shifted to "smart on crime" policies, the state cannot rely on unpredictable parole approval rates and discretionary appropriations for diversion and treatment programs to maintain prison populations at or below capacity. Establishing a process to monitor and assess the effect of sentencing practices, policies, and existing laws on the correctional resources of the state would have a sustainable and reliable effect on the number of incarcerated persons and in how offenders are managed in community programs.

STATE AND NATIONWIDE TRENDS

In the past 25 years, the number of prisoners in the U.S. nearly tripled, while the country's population increased by approximately 25 percent. Historically, the number of prisoners in the U.S. closely tracked general population growth until the 1970s, when a variety of policy changes caused sharp increases in prison populations. In Texas, correctional population numbers have largely mirrored national trends. The correctional institution count of approximately 14,000 prisoners in 1970 has increased to more than 152,000 in fiscal year 2012, a 963 percent increase during the past 40 years. The Texas population increased at a significantly lower rate of 125 percent in the same period. **Figure 1** shows how Texas correctional population changes compare to general population growth in the state since 1970.

FIGURE 1
TEXAS CORRECTIONAL POPULATION AND TEXAS GENERAL POPULATION CHANGE
1970 TO 2010



SOURCES: Legislative Budget Board; Office of State Demographer.

One of states' biggest concerns regarding prison populations is the direct cost of housing large numbers of offenders. Imprisonment is the most expensive form of criminal punishment. Depending on the disposition of the case, the state incurs a different cost for each offender convicted of the same offense degree and level.

Figure 2 shows that it costs $16,104 per year to incarcerate an offender who is convicted of a third-degree felony. It costs $1,066 per year to supervise that same offender on probation.

Legislative Budget Board (LBB) data shows that the 17,000 third-degree felons released in fiscal year 2011 served an average of 2.4 years in prison. Incarcerating offenders with a third-degree felony conviction costs $34,173 more per offender than placing them on probation. Had these low-

FIGURE 2
COST PER OFFENDER FOR A THIRD DEGREE FELONY BY DISPOSITION
FISCAL YEAR 2011

FELONY 1	COMMUNITY SUPERVISION	PRISON
Average Time Served (in years)	4.2	2.4
Average Cost per Year	$1,066	$16,104
Total	**$4,477**	**$38,650**

NOTE: Cost data is from fiscal year 2010.
SOURCE: Legislative Budget Board.

level offenders been placed on probation, they would have served more time under supervision at a lower cost to the state. The large difference is due, in part, to prison guard compensation and inmate healthcare, which must keep pace with the number of incarcerated offenders. Increased demand for prison beds also requires capital expenditures on new facilities or additional contracting with private companies. For the 2012–13 biennium, Texas budgeted nearly $2.5 billion per fiscal year to incarcerate offenders. The relative size of Texas' corrections budget doubled from 4 percent in the late 1980s to 8 percent (General Revenue Funds) by 2012, one of the larger increases among the states during that period.

During the past 20 years that the country saw a marked increase in prison populations and costs, several states implemented "three strikes" policies, which call for automatic minimum prison sentences (including life sentences) for an individual's third conviction, often regardless of other mitigating factors. During the same period, a movement for truth in sentencing grew out of public frustration over inmates being released after only serving a fraction of their sentence. As a result, several states, including Texas, implemented more severe guidelines for parole eligibility or minimum lengths for terms served, keeping offenders incarcerated for longer periods. Many states established sentencing guidelines for crimes, which consider an offender's criminal history, but limits a judge's discretion in sentencing. In a 1999 study by Alfred Blumstein and Allen Beck, research showed that during the 1980s and early to mid-1990s, increased incarceration rates for non-drug offenders were primarily due to recidivists facing much higher chances of jail time and often for longer periods. Texas has not developed sentencing guidelines and instead promotes judicial discretion and the state's unique jury sentencing system. Incarceration rates in Texas increased due to political pressure to enhance various punishments and an increased reliance on criminal punishment to remedy situations. The revision of the Texas Penal Code in 1993 enhanced uniformity of the state's criminal structure, but other changes by the Seventy-third Legislature that year did little to control the growth of prison populations.

In early 2007, Texas prison population projections showed sharp growth, anticipating an increase of nearly 15,000 prisoners by 2012 that would put the state above its bed capacity. As a result, legislators began addressing the projected population increase by implementing policies to reduce the high rate of probation revocation, provide new treatment and diversion options, and improve parole approval rates. The focus on these policies significantly helped control offender populations and avoid prison construction costs. Progress occurred almost immediately with 2010 prison population projections showing a relatively flat population for the next several years, a significant change from predictions just four years prior. This investment in rehabilitative services for both incarcerated and community supervised offenders put Texas at the forefront of criminal justice reform. Maintaining the momentum of the reinvestment policies of treatment, rehabilitation, and diversion, coupled with a recalibration of laws, sentencing practices, and resources allows Texas to continue its focus on cost-effective public safety.

PAST TEXAS EFFORTS TO REVIEW THE PENAL CODE

Comprehensive revisions of the Texas Penal Code occurred almost every decade since 1971 when the State Bar Committee on Revision of the Texas Penal Code was formed to consolidate, simplify, and modernize the code through 1993 when the commission last met. In 1983, under pressure from operating the prison system at capacity and with increasing costs, the Texas Legislature established the one-time Commission on Sentencing Practices and Procedures. It was a 15-member panel, which made recommendations to the Legislature in 1985. Charged with reviewing all sentencing practices and policies in the state, the commission, most notably, recommended encouraging alternatives to incarceration, maintaining juries' participation in sentencing, and not implementing mandatory sentencing guidelines.

Despite the positive reforms that came from previous commissions, prison populations continued to increase during the late 1980s, prompting a significant prison construction effort to address the lack of prison system capacity. In response, Texas established the Punishment

Standards Commission (PSC) in 1991. The Seventy-second Legislature charged PSC with a complete rewrite of the Texas Penal Code and a thorough review of the state's sentencing practices. Specifically it required that the PSC study: (1) punishments prescribed for criminal offenses in Texas; (2) sentencing practices in criminal courts; (3) costs related to prison construction; and (4) the effect of jail and prison overcrowding and lenient parole laws on sentences actually served by defendants convicted of criminal offenses. Composed of 10 legislators and 15 members appointed by the Governor, the PSC completed recommendations for the Seventy-third Legislature in January 1993. The Governor appointees represented district judges, sheriffs, county judges, criminal defense attorneys, law professors, prison wardens, and members of the Courts of Criminal Appeals. To provide the perspective of prosecutors, the PSC hired a prosecuting attorney to assist the commission.

The Criminal Justice Policy Council conducted an in-depth statewide sentencing study. This is the only study on statewide sentencing trends that includes a detailed profile of felons sentenced to community supervision or to the institutional division. This study served as a tool to provide the Texas Legislature "with information necessary to perform a proper revision of the Penal Code and statutes relating to sentencing in criminal cases." Data on over 100 items of sentencing information like court processing, disposition, incident, sentence, and offender characteristics for a sample of offenders was collected.

Several key reforms came from PSC's work. One of the most significant results was the creation of the state jail felony; a fourth-degree felony designed to send non-violent property and drug offenders to state jails and increased community supervision for no more than six months. The Legislature passed a variation of this recommendation but kept the basic premise of reserving more expensive state prison space for the most dangerous offenders. The Legislature also adopted other changes such as increasing the minimum portion of a sentence served by certain violent offenders, but did not adopt recommendations that more closely resembled truth in sentencing legislation. This legislation would have required offenders to serve an increased portion of their sentence (at least 80 percent) by reducing sentence ranges for all felony categories, abolishing parole for discretionary release, and reducing good conduct time that gives an offender credit for time served. The commission did not recommend sentencing guidelines or abolishing the practice of jury sentencing because it would diminish judicial discretion and would not allow for enough sentencing flexibility. Despite the PSC's recommendation to establish a permanent commission to systemically review the effects of criminal justice legislation on prison populations and resources, by statute, the PSC was abolished by September 1994.

SENTENCING COMMISSIONS IN OTHER STATES

As of April 2012, 23 states operated sentencing commissions or similar entities, according to the National Association of Sentencing Commissions. **Figure 3** shows that in 1978, Minnesota established the first state sentencing commission, which was borne out of the truth in sentencing movement. This movement was aimed to align the portion of a sentence many offenders actually served to the sentence that was imposed. The result of the Minnesota commission's work was a grid prescribing sentencing ranges based on severity of the offense and an offender's criminal history.

Over the next two decades, the federal government and nearly 20 states implemented similar commissions, each charged with reviewing sentencing practices and generally promoting truth and equity in sentencing.

Like Minnesota, many state commissions implemented sentencing guidelines for judges, typically in the form of a grid, with a prescribed sentence based on an offender's criminal history and the severity of the crime. States with such guidelines give varying degrees of flexibility to judges—some guidelines are merely advisory, while others represent mandatory ranges, with little latitude for a judge to deviate from sentencing guidelines. These commissions typically produce standardized worksheets for judges to calculate a sentence or to explain why a sentence departed from standards. In all cases, no matter how stringent the sentencing guidelines are, every state has retained some form of judicial discretion, though the emphasis on discretion varies widely. In Missouri, judicial discretion is labeled a cornerstone of the state's sentencing guidelines, which are based on average sentences handed down by judges across the state. As an aid, the Missouri Sentencing Advisory Commission developed an automated risk assessment tool, which recommends a sentence based on the offense and other factors such as criminal history and employment status.

Though other state commissions range in size from as few as 9 members to more than 30, each attempts to provide representation of the various stakeholder groups in the criminal justice system. Commissions often include judges, legislators, prosecutors, defense attorneys, victim's rights advocates, law enforcement officers, corrections officials, and

FIGURE 3
STATE SENTENCING COMMISSIONS, FISCAL YEAR 2012

STATE	ESTABLISHED	TENURE	MEMBERS	SENTENCING STANDARDS	PRIMARY GOALS
Alabama	2000	Permanent	16	Voluntary; worksheets provided to court	Serve as clearinghouse of sentencing practices; Make criminal justice recommendations; Review county jail overcrowding
Arkansas	1993	Permanent	9	Voluntary; sentencing grid provided	Establish standards; Monitor impact of policy on corrections resources
Colorado	2007	Temporary (July 2013)	26	None	Reduce recidivism; Recommend cost-effective use of criminal justice funds; Evaluate sentencing policies and practices
Connecticut	2011	Permanent	23	None	Review on an-going basis criminal justice and sentencing policies and laws
Delaware	1983	Permanent	11	Voluntary; worksheet required	Annually review sentencing guidelines to ensure consistent punishment
District of Columbia	1998	Permanent	20 (15 voting)	Voluntary; sentencing grid provided	Revise sentencing standards
Illinois	2009	Temporary (Dec. 2012)	18 (and ex-officio members)	None	Review of sentencing policies and their impact; Collect and analyze relevant data
Kansas	1989	Permanent	17	Required ranges, with allowances for departure	Develop and review guidelines to promote rational, fair, and consistent sentences
Louisiana	1987	Permanent	21 (19 voting)	Voluntary; sentencing grid provided	Review of sentencing alternatives
Maryland	1999	Permanent	19	Voluntary, sentencing grid and worksheets provided	Promote fair and proportional sentencing guidelines; Maintain a sentencing database
Massachusetts	1994	Permanent	15 (9 voting)	None	Review sentencing standards
Minnesota	1978	Permanent	11	Required ranges, with allowances for departure	Promote truth in sentencing, uniformity, and proportionality; Ensure prison resource needs are more predictable
Missouri	1994	Permanent	11	Voluntary; Automated recommended sentencing system	Recommend sentences based on actual practices; Research and analyze offender population and relevant statistics
Nevada	2007	Restructured in 2007; Permanent	17	None	Evaluate sentencing practices with consideration of fiscal impacts; Evaluate various components of criminal justice system
New Jersey	2009	Restructured in 2009; Permanent	13	None	Review sentencing provisions to promote public safety and efficient use of resources
New Mexico	2001	Permanent	24	None	Research criminal justices issues; Provide resources to all three branches of government
New York	2010	Permanent	23	None	Comprehensively evaluate sentencing laws and practices; Recommend reforms that will improve the quality and effectiveness of statewide sentencing policies

FIGURE 3 (CONTINUED)
STATE SENTENCING COMMISSIONS, FISCAL YEAR 2012

STATE	ESTABLISHED	TENURE	MEMBERS	SENTENCING STANDARDS	PRIMARY GOALS
North Carolina	1990	Permanent	30	Required ranges, with allowances for departure	Establish rational, truthful, and consistent sentences for the state; Review felonies and misdemeanors
Ohio	1990	Permanent	31	Voluntary; sentencing grid provided	Review sentencing statutes and patterns; Make recommendations on necessary statutory changes
Oregon	1995	Permanent	9	Required ranges, with allowances for departure	Develop long-range public safety plan; Fund drug courts; Evaluate legislation for criminal justice impact; Maintain sentencing guidelines
Pennsylvania	1978	Permanent	11	Required ranges, with allowances for departure	Promote equitable and fair sentences for felonies and misdemeanors
Utah	1993	Permanent	27	Voluntary; sentencing grid provided	Set guidelines with discretion for judges and parole board
Vermont	2006	Permanent	17	None	Reduce geographical disparities (Appears not to have met)
Virginia	1995	Permanent	17	Voluntary, worksheets provided	Set guidelines with discretion for judges
Washington	1981	Permanent	20	Required ranges, with allowances for departure	Develop sentencing guidelines to be just and equitable; Serve as information clearinghouse for sentencing data
Federal Government	1984	Permanent	7	Required ranges, with allowances for departure	Establish sentencing grid; Advise Congress and the Executive on crime policy; Collect and analyze crime and sentencing data

Notes: Illinois has a permanent entity that reviews sentencing practices and has reviewed sentencing laws.
Sources: Legislative Budget Board; National Association of Sentencing Commissions.

others. By establishing sentencing commissions, nearly all states with sentencing commissions chose to establish permanent panels to refine sentencing practices continuously. However, commissions in Colorado, Illinois, and South Carolina were set up recently with the intent to end their existence after only a few years. In Illinois for example, after a four-year effort to revise the penal code, the Criminal Law Edit, Alignment, and Reform Commission (CLEAR) recommended the establishment of the Sentencing Policy Advisory Council to review sentencing policies and practices and examine how these policies effect the costs and management of the state's criminal justice system. After three years, the council expired in December 2012.

Many of the early commissions and all of those established in the last decade require a balanced approach to cost and effectiveness, while maintaining public safety. Legislation in Nevada and Colorado explicitly demonstrates this shift in purpose for sentencing commissions with those states looking to control rising corrections budgets. Enabling legislation in Colorado directs the commission "to enhance public safety, to ensure justice, and to ensure protection of the rights of victims, through the cost-effective use of public resources."

Sentencing commissions have addressed costs through recommendations often characterized as getting "smart on crime." For example, in Alabama, based on recommendations from the state's sentencing commission, the Legislature authorized increases in the number of community corrections programs by nearly 80 percent from fiscal years 2003 to 2008. The state estimated that placing offenders in prison, rather than community corrections, would have cost the state more than $23.0 million in operation costs in fiscal year 2008, rather than the $6.1 million appropriated for community corrections that year. Similarly, in 2003, Kansas passed legislation providing for alternative sentencing policies for non-violent drug possession offenders. The Kansas Sentencing Commission operates the program, which requires first and second-time low-level drug offenders to be sentenced to community corrections intensive supervision

instead of being sentenced to prison. Since its implementation, the Kansas program has grown to serve approximately 1,400 offenders per year that otherwise would have received less treatment and supervision. Often sentencing commissions recommend enhancing penalties for some crimes, while minimizing others. In November 2009, for example, the Colorado Commission on Criminal and Juvenile Justice recommended increasing the allowable amount of marijuana (from one ounce to four ounces) that can be possessed and qualify as a petty offense. In the same report, the commission also recommended re-categorizing the level for the first felony offense of selling marijuana to a minor. The re-categorization resulted in an increased penalty.

Another notable example of a comprehensive sentencing commission is that of South Carolina. Established by legislation in 2008, the commission worked closely with the Pew Charitable Trusts' Center on the States. Pew's Public Safety Performance Project is well respected by states working to review their criminal justice systems. In February 2010, the sentencing commission made recommendations to the South Carolina Legislature, which were overwhelmingly approved and implemented that summer. The legislation required a comprehensive review of the state's laws relating to sentencing and parole policies. Significant changes enacted include: expanding the list of violent crimes, creating an attempted murder offense, and requiring drug offenders to pay drug-treatment court fees. At the same time, the new laws reduced the penalty for non-violent burglary, expanded probation options for first and second-time drug possession offenders, and established good behavior incentives for those on supervision. Additionally, the legislation established an oversight committee to monitor implementation and to report on the amount of cost savings, of which 35 percent would be transferred from prisons to probation and parole operations. In its report, the commission anticipated helping the state avoid $317.0 million in new prison construction and save $92.0 million in prison operating costs over the next five years due to a reduction in the number offenders being incarcerated.

ESTABLISH A SENTENCING COMMISSION

Texas, like other states, can engage in a comprehensive effort to balance costs while maintaining public safety by establishing a sentencing commission. Recommendation 1 would amend the Texas Code of Criminal Procedure to establish a permanent sentencing commission to do the following:

- study sentencing practices across the state;
- balance county and state criminal justice responsibilities with resources;
- identify offenses whose penalties should be adjusted to better align them with the severity of the offense;
- analyze how community supervision, parole, and sentencing terms in Texas compare to other states' terms;
- devise an approach that would allow the state to balance sentencing policies with correctional resources; and
- enhance consistency and reduce disparity in sentencing.

Recommendation 1 would be implemented through statutory change and funded through an appropriations rider contingent on enactment of the legislation establishing the sentencing commission. Recommendation 2 would include a contingency rider in Article X of the 2014–15 General Appropriations Bill to appropriate $1.1 million in General Revenue Funds to the Senate and House of Representatives. These funds would be transferred to the commission to maintain its operations and to conduct a study on statewide sentencing practices. The commission would convene every 10 years contingent upon appropriations. This structure would provide a mechanism for the Legislature to consider the corrections system as a continuum, provide a mechanism to address priorities, allow for a recalibration of resources between state and local governments, result in cost savings, and provide data for future reform efforts.

APPROACH CORRECTIONS SYSTEM AS CONTINUUM, RATHER THAN AS DISCRETE, UNRELATED PARTS

The effect of criminal justice legislation and policies on the state budget, individual agencies, local governments, offender service providers, courts, and prison populations can sometimes be underestimated. This is the case especially when legislation affecting any part of the criminal justice system is considered in isolation without accounting for the total effect of all legislation on the system as a whole. Recommendation 1, establishing the sentencing commission, would require the commission to submit their findings and recommendations for modifications to sentences to the Legislature in January 2015. Recommendation 1 would establish a permanent, systematic mechanism to address issues related to sentencing policies and laws that may no longer reflect current needs, circumstances, standards, and values. Allowing 10 years between commission reviews

provides enough time to identify the effects of recently enacted policies. The New York Sentencing Commission is an example of a commission that was established temporarily to simplify sentencing laws after 40 years of evolution and to review punishment for several areas of the law including drug policy. However, after a two-year study and in recognition of constantly evolving sentencing laws, patterns, and offenses, the New York State Commission on Sentencing Reform issued a report in February 2009 successfully recommending implementation of a permanent commission to continually evaluate sentencing laws and policies.

Establishing a commission would allow the state to consider the continuum of penalties and options for managing offenders.

PROVIDE A MECHANISM TO ADDRESS PRIORITIES

A 2011 report by the National Conference of State Legislatures (NCSL) identified one of the seven principles of effective state sentencing and corrections policy as policies that are "resource-sensitive as they affect cost, correctional populations, and public safety." Texas does not have a comprehensive process that allows for a review of sentencing policies to identify offenses that, in light of costs confronting the system, are of lower priority than others, or for the removal of obsolete offenses and addition of other offenses based on evolution of the needs and values of society. The NCSL report states that sentencing policies should "embody fairness, consistency, proportionality, and opportunity." The objective is to treat similar offenders alike while still allowing discretion to choose correctional options that meet the individual offender needs.

Texas has had great success with its diversion initiatives. However, these strategies are not designed to address all inequalities in drug offense penalties and hierarchy of serious drugs offenses. Kansas, as mentioned previously, reclassified its drug offenses by reducing penalties for possession of illegal drugs and requiring in-patient or programs for outpatient community treatment instead of incarceration. Given that more than 29.8 percent, or 22,057 offenders, of Texas' prison, state jail, and intense substance abuse program admissions in fiscal year 2011 were a result of a drug offense with 16,238 being for possession, Texas should consider reforming drug sentencing laws to continue to emphasize prison diversion treatment programs for certain low level possession offenders. In 2011, a bill aiming to do this was filed in Texas. The provisions of the bill would have reduced the punishment for certain offenders of possession of controlled substances from a state jail felony to a misdemeanor. LBB staff estimated that the probable fiscal impact of the provisions of the bill would have saved more than $123 million and decreased demand for state jail beds by 3,480 the first year and 3,817 the second year.

This bill, along with other criminal justice bills proposed last session, were considered in isolation and not as part of any larger strategy to balance offenses and penalties. A sentencing commission could balance changes to punishments and refocus priorities and resources on the most serious offenses.

RECALIBRATE COUNTY-STATE RESPONSIBILITIES AND RESOURCE ALLOCATION

As with other states, the division of responsibility between the state and counties and the availability of resources can frequently create perverse incentives. Texas cost data shows that in fiscal year 2010, it cost the state $44.12 per day to house an adult offender, an average of $3.74 per day to supervise a parolee, and $2.92 per day to monitor an offender on probation. While community supervision and treatment programs are less expensive than prison, county judges may have a financial incentive to sentence offenders to state jail or prison where offenders are the responsibility of the state if the county lacks resources or programs to manage such offenders. Texas has developed strategies to address this issue by providing incentive funding to community supervision departments that implement evidence based supervision programs that aim to reduce offender recidivism. These programs help divert offenders from prison and reduce the number of offenders who are on parole and subject to revocation. While these efforts have had a positive effect on prison admissions, probation and parole revocations accounted for 45.2 percent of prison admissions for fiscal year 2011.

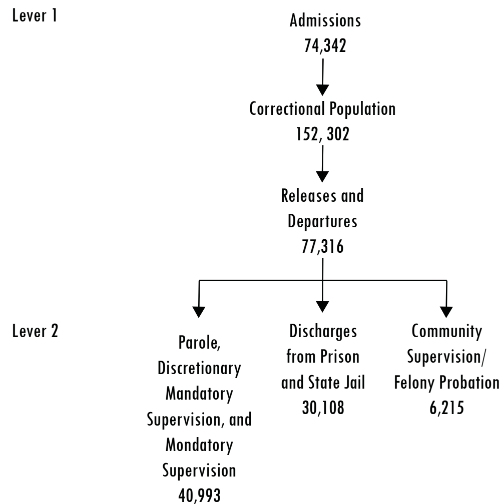
An established body with focus on state and county resource allocation and cost-effective sanctions would help ensure that any sentencing imbalances are identified and rectified early on.

COST SAVINGS THROUGH CHANGES IN SENTENCING AND OFFENSE RE-CATEGORIZATION

Sentencing policies help control prison admissions and sentence lengths while parole decisions control how quickly offenders are released. **Figure 4** shows the two main levers that control prison populations: admissions and releases and departures.

Cost savings can be achieved through policies that change sentencing patterns, re-categorize certain low-level offenses,

FIGURE 4
FACTORS CONTROLLING PRISON POPULATIONS
FISCAL YEAR 2012



Sources: Legislative Budget Board; Texas Department of Criminal Justice.

and limit prison admissions to only dangerous and violent offenders. In addition to reclassifying drug offenses by considering amounts of the drug, type of drug, and intent, some states have also adjusted theft thresholds to using current inflation rates. The Eighty-second Legislature, Regular Session, 2011, considered legislation that would have adjusted the value of the property stolen to account for increases in consumer prices. The theft thresholds found in the Texas Penal Code, Section 31.03, have not been updated since 1993 and 1995. LBB staff determined that raising the threshold for the value of property stolen for both misdemeanor (from less than $50 to less than $100) and certain felony punishment levels (from $1,500 or more to $3,000 or more) would decrease the demands on county and state resources due to shorter terms of probation, or shorter terms of confinement in county jails or prison. Adjusting these values would better align the penalty with the intent of the law when it was first enacted. Without these revisions, a person could be sentenced to prison for stealing an item that 25 years ago would have resulted in only a fine because consumer prices have increased. According to NCSL, at least 21 other states have recognized this inequity and adjusted monetary thresholds for theft crimes.

An example of a bill that targeted public safety and intensive supervision for some of the most violent offenders was introduced in 2011. It would have helped control prison populations by providing that qualifying offenders nearing their discharge date (date offender serves entire sentence) be released to a supervised reentry program. The release would have occurred when offenders were one year from their discharge dates or on the date the individual had served 90 percent of his sentence.

Establishing a sentencing commission to identify offenses and penalties that can be compared and reclassified accordingly would ensure that cost savings are achieved while reducing sentencing inequities.

PROVIDE CURRENT SENTENCING DATA NEEDED FOR CRIMINAL JUSTICE COST AND POPULATION PROJECTIONS AND INFORMED POLICY-MAKING

The only study on statewide sentencing trends that included a detailed profile of felons sentenced to community supervision or the institutional division was conducted in 1993. The criminal sentencing data used by LBB staff is 20 years old and does not provide victim information, prior criminal history or offense details. Data available at the state level lacks the detail needed to assess the effect of proposed changes in sentences. For example, data on drug types and actual amounts possessed are not included in the data the Texas Department of Criminal Justice (TDCJ) retains on offenders. TDCJ only has data on disposition of the case, offense conviction, sentence imposed, and sentence served.

The sentencing study required by Recommendation 1 would be led by the LBB's Criminal Justice Data Analysis (CJDA) team and would provide the commission with a data profile of felons sentenced in Texas. The CJDA team projects adult and juvenile correctional populations, performs fiscal and criminal justice impact analysis of proposed legislation, calculates recidivism rates for adult and juvenile correctional populations, and provides uniform cost data for criminal justice populations. Coordinating the sentencing dynamics project and conducting the data analysis would also provide LBB staff with the data it lacks to more accurately estimate criminal justice savings and population changes for proposed correctional policy changes.

Updated sentencing information would provide the Legislature with the necessary information to revise sentencing laws and identify disparities in sentencing statutes and practices. This would allow the sentencing commission to craft recommendations that could lead to proportional, consistent, and fair penalties.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendation 1 would cost the state $1.15 million in General Revenue Funds for the 2014–15 biennium. As shown in **Figure 5**, the biennial cost to operate the commission assumes 3 new full-time-equivalent positions: an administrative assistant, an entry level attorney, and a director to oversee the operations of the commission. This cost includes salary and benefits, office supplies, office space, travel and housing expenses, and resources needed to provide support to the 20 members of the commission and the cost to implement the sentencing dynamics study.

FIGURE 5
FIVE-YEAR FISCAL IMPACT OF ESTABLISHING A SENTENCING COMMISSION
FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE FUNDS	PROBABLE ADDITION/ (REDUCTION) OF FULL-TIME-EQUIVALENT POSITIONS
2014	($882,424)	3.0
2015	($263,089)	3.0
2016	--	--
2017	--	--
2018	--	--

Source: Legislative Budget Board.

Recommendation 2 would include a contingency rider in Article X of the 2014–15 General Appropriations Bill to appropriate funds to the Senate and the House of Representatives. These funds would be transferred to the commission to pay for its operations. **Figure 5** shows the cost to operate the commission and conduct the study by fiscal year.

Another component of the fiscal impact is the cost associated with the collection of sentencing information for a sample of felons convicted in select counties in Texas. This data collection will require detailed data coding of individual cases providing offense, disposition, incident, sentence, and offender characteristics. Data for the 1991 sentencing study was obtained by contracting with each of the selected urban and rural counties. The now-defunct Criminal Justice Policy Council hired approximately 125 prosecutors and administrative staff to code over 7,700 felony offender files. Based on this information and previous studies conducted by the CJDA team, the proposed study would require the coding of 10,000 offender files at approximately two hours each. To fulfill its mandate the CJDA team would be authorized to contract with a university or other suitable entity to carry out the coding of the files. The data collection would be completed within the first year of the biennium, giving the CJDA team sufficient time to analyze the data and share its findings with the commission prior to publishing the report in January 2015.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

REVISE MEDICALLY RECOMMENDED INTENSIVE SUPERVISION ELIGIBILITY CRITERIA TO IMPROVE IDENTIFICATION OF QUALIFYING OFFENDERS

In Texas, offenders who no longer pose a threat to public safety due to a medical condition can be eligible for early parole under the Medically Recommended Intensive Supervision Program. Offenders who are terminally ill, elderly, physically handicapped, mentally ill, or in need of long-term care are eligible for parole consideration by the Texas Board of Pardons and Paroles. Approved offenders are released to medically suitable settings where they can receive clinically appropriate and cost effective treatment. By placing approved offenders in medically suitable settings, the state can offset state medical care costs for offenders who are eligible for public health benefits such as Medicaid or Medicare upon release.

Correctional managed healthcare providers, the Texas Correctional Office on Offenders with Medical or Mental Impairments, and the Texas Board of Pardons and Paroles work together to identify and approve eligible offenders for medical release. Referrals for Medically Recommended Intensive Supervision are screened and reviewed by the Texas Correctional Office on Offenders with Medical or Mental Impairments and then referred to the Texas Board of Pardons and Paroles for a decision. In fiscal year 2011, the Texas Correctional Office on Offenders with Medical or Mental Impairments received 1,807 referrals from medical providers, families of offenders, offenders themselves, and others. Of these referrals, the Parole Board approved 91 for medical release.

Existing eligibility criteria for Medically Recommended Intensive Supervision produce a high volume of referrals, but many offenders are not approved by the Parole Board for release under the program because their medical condition is not severe enough to prevent them from being a risk to public safety. Revising eligibility criteria would increase the efficiency of the screening process by limiting the number of offenders who are referred but do not meet the Texas Board of Pardons and Paroles' requirements for medical release. Additional changes to the eligibility criteria may result in the release of more offenders in need of high cost medical services to more cost effective settings such as nursing home facilities.

FACTS AND FINDINGS

- The Texas Correctional Office on Offenders with Medical or Mental Impairments' workload increases each year. From fiscal years 2010 to 2011, the total number of referrals to the Texas Correctional Office on Offenders with Medical or Mental Impairments increased 25 percent from 1,443 to 1,807 referrals. Of the 1,807 initial referrals, 62 percent met statutory eligibility criteria and the office did additional work to prepare information about each offender for the Texas Board of Pardons and Paroles' consideration.
- The total number of elderly offenders screened every year is not accurately represented in the referral data. As part of its annual review of elderly offenders, the Texas Correctional Office on Offenders with Medical or Mental Impairments screened an additional 756 elderly offenders who were not included in the total number of referrals in fiscal year 2011.
- The number of Medically Recommended Intensive Supervision releases approved by the Texas Board of Pardons and Paroles has remained flat since fiscal year 2007. In fiscal year 2011, the Texas Board of Pardons and Paroles approved 26 percent of all cases, or 91 offenders, presented for Medically Recommended Intensive Supervision consideration.
- According to the Texas Correctional Office on Offenders with Medical or Mental Impairments, the majority of offenders approved for Medically Recommended Intensive Supervision are released to their homes or with relatives. The remaining offenders are placed in medically suitable settings such as nursing homes or county hospices.
- Of the 147 offenders who were referred for Medically Recommended Intensive Supervision consideration but died without being released in fiscal year 2011, 29 percent were sex offenders. These offenders are generally ineligible for release under Medically Recommended Intensive Supervision due to their offense even though they may have had serious medical conditions.

CONCERNS

- Broad eligibility categories yield a high volume of cases that are never presented to the Texas Board of Pardons and Paroles because their medical condition

is not severe enough to prevent them from being a risk to public safety. The processing of these referrals requires time and resources that could be focused on offenders whose medical condition makes them more likely to be considered for release on Medically Recommended Intensive Supervision.

- ♦ Despite the effort in screening elderly offenders by both the Texas Correctional Office on Offenders with Medical or Mental Impairments and the medical providers, none of the 52 elderly offenders identified during the annual review were approved for release by the Texas Board of Pardons and Paroles in fiscal year 2011.
- ♦ Although only 8 percent of offenders released on Medically Recommended Intensive Supervision require skilled nursing, it takes the Texas Correctional Office on Offenders with Medical or Mental Impairments up to three weeks to find placement for offenders. This is primarily due to a lack of post-incarceration facilities willing to house ill offenders.
- ♦ Eligibility restrictions related to convictions and types of offense limit the number of referrals who could meet Medically Recommended Intensive Supervision medical criteria. Offenders with aggravated or sex offenses who did not meet statutory exceptions accounted for 90 percent of all referrals who were ineligible for the Texas Board of Pardons and Paroles consideration in fiscal year 2011.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Amend statute to eliminate the elderly category as one of the eligibility criteria for Medically Recommended Intensive Supervision.
- ♦ **Recommendation 2:** Amend statute to remove offense exclusions related to aggravated and sex offenses currently used as disqualifying criteria for Medically Recommended Intensive Supervision.
- ♦ **Recommendation 3:** Include a rider in the introduced 2014–15 General Appropriations Bill directing the Texas Department of Criminal Justice to work with the Texas Department of Aging and Disability Services and the Health and Human Services Commission to conduct a study examining the option of contracting with a private entity to house offenders in need of skilled nursing or 24-hour care.

DISCUSSION

The Medically Recommended Intensive Supervision program (MRIS) allows for the early parole of certain offenders. Qualifying offenders must either be terminally ill, elderly, physically handicapped, mentally ill, mentally disabled, or require long-term care. Offenders approved for release are placed in alternative non-correctional settings where the state can continue providing the same level of care but at a lower cost. Incarcerated offenders are ineligible for public health benefits such as Medicare or Medicaid, thus the state bears the full financial responsibility for their medical costs. In alternative settings like nursing homes, however, the state can draw down federal funds to offset medical care costs for offenders released on MRIS.

Eligible offenders are referred for MRIS consideration to the Texas Correctional Office on Offenders with Medical or Mental Impairments (TCOOMMI). Offenders can either refer themselves or be referred by other sources such as prison medical staff, daily hospital census reports, family members, attorneys, and advocates. Statute includes the eligibility criteria for MRIS consideration. These categories are defined in the Texas Board of Pardons and Parole's (Parole Board) policy as follows:

- Terminally ill—having an incurable condition expected to result in death within six months regardless of treatment and requiring skilled nursing, hospice, or home healthcare;
- Elderly—an offender age 65 or older;
- Physically handicapped—having a severe, chronic disability that is likely to continue indefinitely and results in substantial functional limitations;
- Mentally ill—an illness, disease or condition that either substantially impairs and offender's thoughts, perception, or reality, emotional process, judgment, or grossly impairs an offender's behavior, as manifested by recent disturbed behavior;
- Mentally retarded—significantly sub-average general intellectual functioning that is concurrent with deficits in adaptive behavior and originates during the developmental period until the age 18; and
- Long-term care—a person who requires nursing care and is deficient in the area of self-care and where there is reasonable medical probability that the clinical condition(s) producing that inability will not change.

Because referrals to TCOOMMI are based solely on medical condition or age, TCOOMMI is responsible for screening and reviewing referrals to determine whether they meet the statutory requirements of the program. TCOOMMI must consider the type of offense committed by the offender under review. Offenders with death sentences as well as those with certain violent capital offenses are ineligible for consideration. Offenders with aggravated and sex offenses are also excluded from consideration with few exceptions. Offenders who require long-term care or are terminally ill can be considered for MRIS even if they have an aggravated offense. Sex offenders can be considered if they are in a persistent vegetative state or have organic brain syndrome with significant to total mobility impairment. These exceptions, often called House Bill 2611 provisions, are the result of legislation passed by the Eightieth Legislature, 2007. Another provision found in House Bill 431 allows offenders convicted of a state jail felony to be eligible for MRIS consideration. As a result, eligible state jail felons can be paroled on MRIS by a sentencing judge.

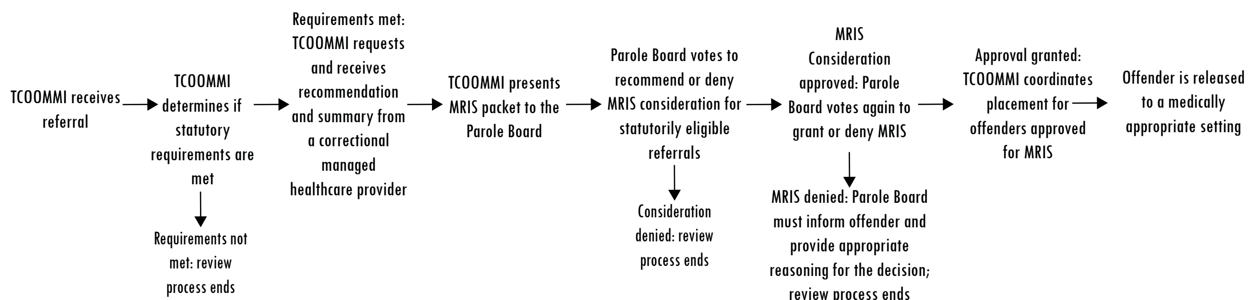
Once an initial referral is screened and found eligible, TCOOMMI requests a medical summary and medical recommendation from medical staff. Medical summaries indicate the qualifying diagnosis and current medical situation of the offender as well as the offender's future medical outcome and chances of recovery. The Parole Board reviews the offender's information and issues a decision based on the offender's medical evaluation and risk to public safety. **Figure 1** shows the steps involved in the review process of MRIS referrals. Upon approval by the Parole Board, the offender must continue under the care of a physician in a medically suitable placement, comply with standard parole requirements and the terms and conditions of the MRIS program, and follow the approved release plan prepared by TCOOMMI. An offender on MRIS can be revoked and returned to prison or discharged once his or her sentence is completed. Since the inception of the program in 1991, 1,448 offenders have been released on MRIS.

MRIS CASELOAD SNAPSHOT

Referrals to TCOOMMI increased steadily from fiscal years 2007 to 2011. Referrals increased by 25 percent from fiscal years 2010 to 2011, from 1,443 to 1,807 referrals. However, this increase has not resulted in more offenders being referred to the Parole Board.

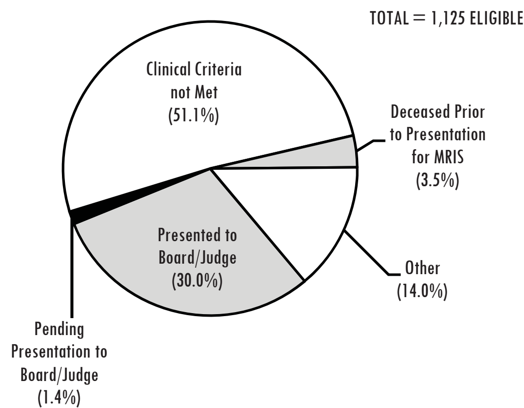
In fiscal year 2011, of the 1,807 referrals screened by TCOOMMI, 62 percent met statutory requirements and were found eligible for consideration by the Parole Board. To be eligible, an offender must meet at least one eligibility category, as defined in Parole Board policy, and not have a disqualifying conviction. Despite the 1,125 offenders meeting these criteria, only 337 of all referrals were presented to the Parole Board or judge. **Figure 2** shows TCOOMMI's classification of all referrals eligible for consideration by the Parole Board in fiscal year 2011. Of the 1,125 eligible referrals, TCOOMMI classified 51 percent of these cases as not meeting clinical criteria despite meeting statutory requirements. This classification includes a variety of referral types such as elderly offenders without a medical condition, terminally ill offenders who have more than six months to live, and previously presented and denied MRIS offenders whose medical condition had not deteriorated since the Parole Board's denial. Every 30 days, TCOOMMI re-reviews all offenders who have been previously presented and denied MRIS by the Parole Board. TCOOMMI requests a new medical summary from the medical providers to assess the health status of the offender. Most of the offenders re-reviewed require long-term care or are terminally ill.

FIGURE 1
TEXAS MEDICALLY RECOMMENDED INTENSIVE SUPERVISION REVIEW PROCESS, AS OF OCTOBER 2012



Source: Legislative Budget Board.

FIGURE 2
TOTAL NUMBER OF MEDICALLY RECOMMENDED INTENSIVE SUPERVISION REFERRALS ELIGIBLE FOR CONSIDERATION BY THE TEXAS BOARD OF PARDONS AND PAROLES, FISCAL YEAR 2011



NOTE: "Clinical Criteria Not Met" includes a variety of offenders whose classification may not be medically based. "Other category" includes offenders who were referred to a unit medical provider and offenders with active detainers.
SOURCE: Texas Correctional Office on Offenders with Medical or Mental Impairments.

However, their condition usually does not vary significantly from the previous review making them unlikely candidates for MRIS release. The re-review process is time consuming and offenders in this pool are not typically presented to the Parole Board.

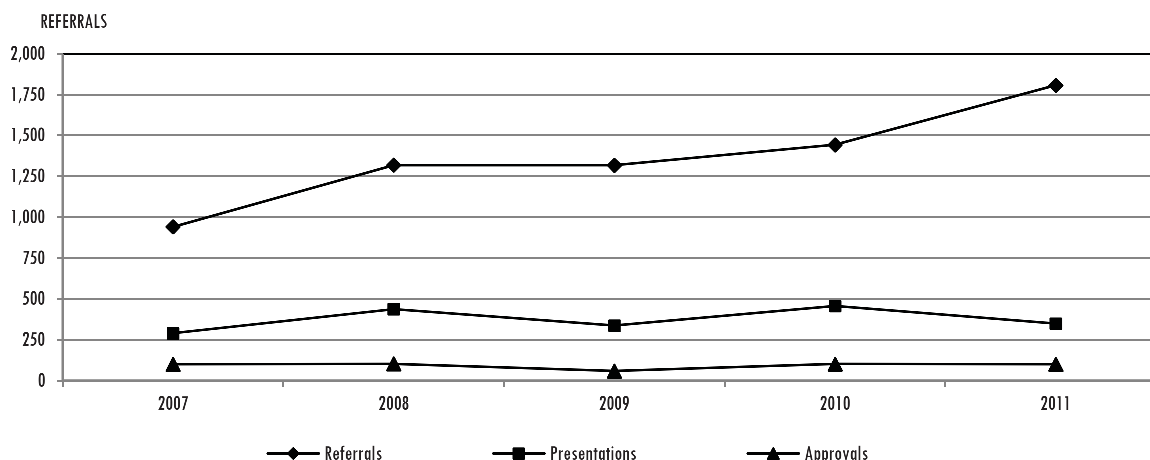
In some cases, TCOOMMI did not refer offenders without a medical condition to the Parole Board even though these cases met statutory requirements. For example, the elderly category, as defined by Parole Board's policy, requires only that an offender is at least age 65 to be eligible for MRIS consideration. All other categories require a medical condition as the primary basis for consideration. TCOOMMI did not refer certain offenders to the Parole Board in order to manage its own caseload as well as the Parole Board's. In addition, certain offenders such as elderly offenders may not have been referred because, historically, the Parole Board has not approved these types of cases for release. If TCOOMMI were to refer all cases that met statutory requirements, both TCOOMMI and the Parole Board would have to manage an exceedingly high workload on a day-to-day basis.

The total number of referrals screened by TCOOMMI in fiscal year 2011 does not accurately reflect TCOOMMI's annual workload. In fiscal year 2011, TCOOMMI screened an additional 756 referrals as part of its annual review of the elderly offender population. Ever year, TCOOMMI reviews all offenders who are age 65 and older who meet statutory requirements for eligible offenses to determine if they qualify for MRIS release. In fiscal year 2011, out of the 756 elderly offenders screened, TCOOMMI requested medical summaries for 52 elderly offenders. Of the 52 elderly offenders, 15 were found eligible by TCOOMMI but only 8 were presented to the Parole Board. To grant MRIS release, the Parole Board must first vote to determine whether to recommend or deny MRIS consideration. If the Parole Board recommends MRIS consideration, it must then vote again to determine whether the case should be approved or denied MRIS. Of the eight cases presented to the Parole Board, six were denied MRIS consideration and two were denied MRIS. The majority of the 52 elderly offenders were classified as sex offenders and a few had committed an aggravated offense. Despite the effort put into screening elderly offenders by TCOOMMI and medical providers, none of the identified offenders were released on MRIS in fiscal year 2011 on the basis of age.

Eligibility restrictions related to offenses have limited the number of eligible referrals for consideration by the Parole Board. In fiscal year 2011, there were 361 sex offenders who did not meet House Bill 2611 criteria and 253 offenders with aggravated offenses who were not terminally ill or require long-term care. These referrals were automatically ineligible for MRIS consideration due to the offender's conviction. Overall, offenders with aggravated or sex offenses who did not meet program exceptions accounted for 90 percent of all MRIS referrals who were ineligible for Parole Board consideration in fiscal year 2011. Additionally, during this year, sex offenders represented the largest share of referrals who died during the process for MRIS consideration during fiscal year 2011. Of the 147 offenders who had been referred for MRIS consideration but died without being released in fiscal year 2011, 29 percent were sex offenders. These offenders are generally ineligible for release under MRIS due to their offense even though they may have had serious medical conditions that led to their death. Statute allows only sex offenders in a persistent vegetative state or who have organic brain syndrome with significant to total mobility impairment to be eligible for MRIS.

As referrals have increased, MRIS approvals granted by the Parole Board have remained flat. **Figure 3** shows the number of referrals received by TCOOMMI, cases presented for

FIGURE 3
MEDICALLY RECOMMENDED INTENSIVE SUPERVISION REFERRALS, PRESENTATIONS, AND APPROVALS FISCAL YEAR 2007 TO FISCAL YEAR 2011



Source: Texas Correctional Office on Offenders with Medical or Mental Impairments.

MRIS consideration, and MRIS approvals by the Parole Board since fiscal year 2007.

During fiscal year 2011, TCOOMMI presented 349 cases to the Parole Board and sentencing judges for MRIS consideration. In fiscal year 2011 337 cases were referred, and 12 cases were carried over from the previous fiscal year. **Figure 4** shows the disposition of all cases presented for vote during fiscal year 2011. Despite the increased caseload in fiscal year 2011, cases TCOOMMI presented to the Parole Board decreased by 24 percent from 457 cases in fiscal year 2010 to 349 cases in fiscal year 2011. Of the 349 cases presented for MRIS consideration in fiscal year 2011, 100 were approved. The Parole Board approved 91 of the 100 cases and the remaining nine were approved by sentencing judges. More than half (63 percent) of all cases presented to the Parole Board were denied consideration primarily because of the threat the offender posed to public safety.

Figure 5 shows the number of MRIS referrals presented to the Parole Board and the number of approvals granted by category. Although long-term care offenders were presented in larger numbers, more terminally ill offenders were approved in fiscal year 2011. The overall approval rate in fiscal year 2011 was 29 percent.

FIGURE 4
DISPOSITION OF CASES PRESENTED TO THE PAROLE BOARD FOR MEDICALLY RECOMMENDED INTENSIVE SUPERVISION CONSIDERATION, FISCAL YEAR 2011

STATUS	TOTAL	PERCENTAGE
Approved for Release	99*	28%
Consideration Denied	219	63
Denied MRIS	16	5
Deceased Pending Release	7	2
Pending Decision (carry over from Fiscal Year 2010)	9	3
Total	**350**	**100%**

Note: The actual number of votes (350) was greater than the actual number of presentations recorded (349) by one vote given that one case received two votes during a single presentation with the Parole Board approving, withdrawing the approval due to new information and then denying consideration.
Source: Texas Correctional Office on Offenders with Medical or Mental Impairments.

FIGURE 5
MEDICALLY RECOMMENDED INTENSIVE SUPERVISION CONSIDERATIONS AND RELEASES, FISCAL YEAR 2011

CATEGORY	REFERRALS PRESENTED	REFERRALS APPROVED	APPROVAL RATE
Terminally Ill	129	49	38%
Physically Handicapped	8	3	38
Elderly	12	0	0
Long-term Care	196	48	24
Mentally Ill	4	0	0
Mentally Retarded	0	0	0
Total	**349**	**100**	**29%**

Note: Four approved offenders were reclassified from the elderly to the long-term care category after being classified erroneously.
Source: Texas Correctional Office on Offenders with Medical or Mental Impairments.

The number of approvals does not correlate with the number of actual releases during the year. Of the 100 offenders approved for MRIS release in fiscal year 2011, only 85 offenders were released. As of August 31, 2011, three offenders were pending release, and nine offenders had died pending release. The approval of three cases was withdrawn as new information became available.

The number of MRIS referrals and approvals in fiscal year 2011 show that present eligibility categories produce a high volume of referrals, but that these referrals do not result in many offenders being released under the program. This underscores the need to improve existing eligibility requirements.

Recommendation 1 would amend Government Code, Section 508.146 to eliminate the elderly category as one of the eligibility criteria for MRIS. This recommendation would eliminate the need for an elderly category which currently sets age as the only basis for consideration. While elderly offenders are typically less mobile and have more age-related chronic health problems, this alone does not make them less of a threat to public safety. An existing medical condition, not age, should be the primary basis for consideration especially when an offender is elderly but self sufficient. Eliminating the elderly category will allow TCOOMMI to focus its resources on referrals with a higher likelihood of being approved by the Parole Board. Recommendation 2 would eliminate exclusions related to aggravated and sex offenses. Existing restrictions on these types of offenses narrow the pool of sick and potentially eligible offenders as evidenced by referral data from fiscal year 2011.

MEDICAL PAROLE IN OTHER STATES

During the past year, several states enacted laws modifying their eligibility criteria for medical parole. In 2011, Arkansas, Rhode Island, and Colorado redefined their eligibility requirements. Arkansas updated its medical parole eligibility criteria as part of its efforts to contain prison costs and ease overcrowding. Arkansas changed its definitions of "terminal illness" and "permanent incapacitation." Terminally ill is now defined as an incurable condition caused by illnesses or disease likely to cause death within two years. "Permanently incapacitated" is defined as a medical condition that is not necessarily terminal but that renders the offender permanently and irreversibly incapacitated and requires immediate long-term care. By extending the life expectancy of terminal offenders by 12 more months, Arkansas hopes to identify and release terminal offenders earlier to realize cost savings.

Like Arkansas, Rhode Island considers offenders for medical parole who are terminally ill and permanently physically incapacitated. However, in 2011, it amended its eligibility to include, as a separate category, offenders who are "severely ill." Severely ill is defined as suffering from a significant and permanent or chronic physical or mental condition that (1) requires extensive medical or psychiatric treatment with little to no possibility of recovery and (2) precludes significant rehabilitation from further incarceration. Severely ill offenders are considered for medical release only when their treatment causes the state to incur exorbitant expenses as a result of continued and frequent medical treatment during incarceration. Rhode Island's approach is atypical as most states only allow offenders who are terminal or entirely incapacitated from being considered for medical release.

Colorado lowered its age requirement for consideration from age 65 to age 60. Offenders must have also been diagnosed as suffering from a chronic infirmity, illness, condition, disease, or mental illness as well as being incapacitated to the extent that the offender is not likely to pose a risk to public safety. Offenders who meet the age requirement and whose condition requires costly care or treatment are also eligible for consideration provided they do not pose a risk to public safety. Colorado also lifted restrictions on certain felonies as a way to increase the number of additional offenders who may qualify for medical parole. In 2011, Colorado passed legislation to allow offenders convicted of certain violent offenses to be considered for medical parole. Previously, Colorado prohibited both violent and sex offenses. However, it now allows sex offenders to be considered for medical parole.

POST INCARCERATION FACILITIES FOR MRIS OFFENDERS

According to TCOOMMI, of the offenders released under MRIS in fiscal year 2011, approximately 8 percent were placed in nursing homes or hospices. Although a small percentage of offenders required nursing or hospice care in fiscal year 2011, it took TCOOMMI up to three weeks to find placement for these offenders primarily because nursing homes are not willing to house offenders. Elderly offenders are the fastest growing group of the offender population and access healthcare resources at a higher rate than younger offenders. As more offenders requiring skilled nursing are approved for MRIS release, the lack of placement options may constrain the number of actual releases. By placing qualifying offenders in alternative settings, the state would decrease the cost of medical care provided to seriously incapacitated offenders. These offenders, upon MRIS release,

may qualify for public health care such as Medicaid or Medicare. For example, the cost of medical care for an offender on Medicaid would be funded jointly by Federal Funds (approximately 58 percent) and General Revenue Funds (approximately 42 percent).

The availability of adequate post incarceration facilities could also encourage the Parole Board to release more qualified offenders. In addition to cost savings, alternative settings could allow for the release of those offenders who, though incapacitated, may be unlikely to be approved by the Parole Board for release with family members.

Recommendation 3 would include a rider in the introduced 2014–15 General Appropriations Bill directing the Texas Department of Criminal Justice (TDCJ) to conduct a study examining the option of contracting with a private entity to house offenders in need of skilled nursing, or 24-hour care. TDCJ would coordinate with the Texas Department of Aging and Disability Services and the Health and Human Services Commission to conduct the study, which would assess the cost effectiveness of contracting with a private entity and consider options for using Medicaid to pay for eligible offenders' medical care.

FISCAL IMPACT OF THE RECOMMENDATIONS

While these recommendations would not have a fiscal impact in the 2014–15 biennium, Recommendation 1 would increase the efficiency of TCOOMMI's screening process by eliminating the number of offenders who qualify based solely on age. This would allow TCOOMMI to focus resources on offenders whose medical conditions make them better candidates for MRIS release. Recommendation 2 would expand eligibility criteria to include offenses which may result in the release of offenders in need of high cost medical services to more cost effective settings such as nursing home facilities.

The introduced 2014–15 General Appropriations Bill includes a rider to implement Recommendation 3.

IMPROVE THE IMPLEMENTATION AND ASSESSMENT OF LOCAL JUVENILE PROBATION PROGRAMMING TO ENSURE QUALITY

For most youth referred to the Texas juvenile justice system, the local courts and probation department are the only parts of the justice system they will experience. Local probation departments supervise more than 97 percent of those who receive services. Given the number of youth the juvenile probation system serves, resources must be maximized by spending funds on effective programs. The state establishes some standards and requirements for the use of state funds in probation, but program design and implementation are controlled locally. Some local departments have the resources and expertise to perform sophisticated program design and evaluation, while others do not. Providing technical assistance to probation departments to help them continually improve services at the county level could minimize the demand for more expensive and intensive services at the state level, increase public safety, and improve the outcomes for youth.

CONCERN

- Local probation departments vary significantly in their resources and expertise in designing and evaluating local programs. If departments cannot thoroughly evaluate their programs, they may continue ineffective practices that do not improve outcomes for youth and result in more social and financial costs for Texans.

RECOMMENDATION

- **Recommendation 1:** Include a rider in the introduced 2014–15 General Appropriations Bill directing the Texas Juvenile Justice Department to use 2 full-time-equivalent positions and $150,000 in fiscal year 2014 and $144,000 in fiscal year 2015 in the Central Administration strategy to increase technical assistance for program design and evaluation for programs operated by juvenile probation departments.

DISCUSSION

While some states operate both the juvenile probation and corrections systems, juvenile probation in Texas operates under local control. However, the state is involved in probation by distributing funds, providing training, establishing standards, and monitoring local departments and facilities to ensure compliance with those standards. From fiscal years 1982 to 2011, the Texas Juvenile Probation Commission (TJPC) distributed state grants to juvenile boards to operate juvenile probation departments, place youth in detention and correctional facilities, and fund programming in the communities. In fiscal year 2010, funding for juvenile probation included: state funds, approximately 28 percent; county funds, 71 percent; and Federal Funds, 1 percent. The proportion of funding the state provides to each department varies. Larger, urban departments typically rely less on state funding, while smaller, rural departments receive proportionately more of their budgets from state grants.

In contrast to probation, the state administers a separate correctional facility system, which was operated by the Texas Youth Commission (TYC) through most of fiscal year 2011, and since then, by the Texas Juvenile Justice Department (TJJD). Local judges can commit youth to the state juvenile correctional facilities or certify them as adults to be tried in the adult system. Most youth who participate in the juvenile justice system have not entered state juvenile correctional facilities nor been certified as adults. Local probation departments supervise more than 97 percent of those who receive services.

The organization of the state agencies involved in the juvenile justice system has undergone significant reforms in the past several years. Following allegations of abuse of youth in state correctional facilities, the Eightieth Legislature, Regular Session, 2007, passed legislation to address safety, improve the reporting of abuse, and reduce commitments to the state facilities. Admissions to state facilities have been declining since fiscal year 2007, in part due to legislation preventing judges from committing youth to TYC for misdemeanor offenses. The Eighty-first Legislature, Regular Session, 2009, appropriated TJPC funds for a Community Corrections Diversion Program intended to further incentivize local departments to reduce commitments to TYC. Most recently, the Eighty-second Legislature, Regular Session, 2011, abolished TJPC and TYC and established TJJD, which began operating December 1, 2011. The agency has been tasked with developing a continuum of services for youth and to balance rehabilitation with public safety. TJJD had several changes to leadership and organizational structure during its first year of operation.

The state's role in juvenile justice is still being defined, which provides an opportunity for the Texas Legislature to reset priorities and redirect resources. During this period of reform, the number of youth under supervision has been declining, but the proportion of youth who are supervised solely by local probation departments has been increasing. Given limited state and local funds for programming and services, efficient use of resources is crucial. Designing programs based on current juvenile justice research, implementing those programs as intended, and evaluating the effects of those programs on different populations would help departments allocate their resources to what is most effective at reducing recidivism, improving outcomes for youth, and increasing public safety.

ISSUES IN PROGRAM DESIGN, EVALUATION, AND IMPLEMENTATION

According to the U.S. Bureau of Justice Assistance, for programs to be ready for evaluation, program designers must be able to document their goals and objectives and the interventions they use to achieve those goals and objectives. Program design should be based on theory or prior evidence to explain the connection between strategies and expected outcomes. Lastly, data must be collected on those expected outcomes that should reasonably indicate achievement of or progress toward a goal. The process of designing a program that can be evaluated can be structured through the use of a logic model. Logic models are graphics or schematics that specify the assumed relationships among program goals, objectives, resources, activities, outputs, and outcomes. They require a program planner to think systematically about and articulate what a program is intended to achieve, how the program will do it, and how the designer will measure whether or not it is working.

The logic model articulates a theory about how the program is supposed to work. Evaluations can be used to test that theory. Evaluation and performance measurement are sometimes used as interchangeable terms. However, the National Juvenile Justice Evaluation Center defines them differently. Performance measurement involves reviewing process and outcome measures, and evaluation goes a step further, using research and statistical methods to determine whether program outcomes can be attributed to the program or other factors. The most rigorous evaluations involve random assignment to the intervention, fidelity to the program design, and a statistical evaluation. When random assignment is not possible, there are other techniques for comparing outcomes between those who participate in a program versus those who do not. However, it becomes more difficult to determine whether there are unmeasured differences between the two groups that could affect the results.

Several organizations review research literature on juvenile justice programming and identify those programs meeting high standards for evidence of effectiveness. These organizations, such as the Office of Justice Programs, the Center for the Study and Prevention of Violence and the Office of Juvenile Justice and Delinquency Prevention give practitioners a starting point for potential programs to use in their jurisdictions. However, in practice, departments often adapt model programs to suit their circumstances. This approach undermines the similarity of their program to the programs that were evaluated, and therefore can negatively affect outcomes. If a department uses an "evidence-based" model, then training, protocol monitoring, and technical support are important to maintaining fidelity to the model. These activities must be ongoing to address staff turnover and deviations from policy. Without sufficient implementation support, resources spent on the program can be wasted. For some departments, attempting to implement a model program may not be the best option. There may be a lack of specialized providers needed for certain programs in a community, especially in rural areas. Training and licensure costs to implement some of these model programs may be more costly than local programs, which might be effective but lack sufficient evaluation research. In these cases, a more efficient option may be to focus on ensuring that locally developed programs have solid foundations in current juvenile justice theory and evaluating those programs rigorously to continually improve them.

APPROACHES TO ENHANCING JUVENILE JUSTICE EFFECTIVENESS IN SELECTED STATES

These examples illustrate some of the ways other states encourage the use of evidence-based practices and program evaluation in juvenile justice. Most of these initiatives have been implemented recently, and, therefore, limited information about their success is currently available.

FLORIDA: USE RISK-ADJUSTED RECIDIVISM AND COST EFFECTIVENESS ANALYSIS

The Florida Department of Juvenile Justice (DJJ) uses three primary mechanisms to evaluate programs and components: quality assurance, outcome evaluation, and program accountability measures (for residential commitment only).

For quality assurance, as mandated by the Florida legislature, DJJ establishes minimum thresholds of performance for each program component. Then a quality assurance team conducts a site visit and examines documents, and interviews staff, youth, and others to ensure program providers are meeting department and legal standards. The team forms a consensus rating of the provider, and then has an exit conference with the provider to review their rating.

For outcome evaluation, DJJ analyzes recidivism data annually for more than 1,000 programs and case management units.

For program accountability measures, DJJ is mandated to evaluate the effectiveness of residential commitments of youth. DJJ collaborated with the independent Justice Research Center to create the program accountability measures. The program accountability measures model uses a risk assessment to estimate the probability that participating youth will recidivate. This assessment is then compared with how those youth actually perform after release to measure the relative effectiveness of the program. This process ensures that programs serving more difficult youth are not inappropriately compared to programs serving lower-risk youth. The tool also compares program costs, so it can be used to calculate cost-effectiveness.

These three mechanisms have been in place for more than six years, and other system reforms occurred during this period. According to the latest Comprehensive Accountability Report by DJJ, the juvenile crime rate and the number of youth referrals to the department and have fallen to their lowest point since 1990.

PENNSYLVANIA: PROVIDE SUPPORT INFRASTRUCTURE AND TECHNICAL ASSISTANCE

Pennsylvania has established a juvenile justice resource center to bring together multiple agencies and stakeholders to support community planning for the implementation of evidence-based program models and to improve the quality of interventions for juveniles in Pennsylvania. The resource center has two components: the evidence-based prevention and intervention support center (EPISCenter) and the quality improvement initiative (Qii). The EPISCenter educates practitioners about the benefits of evidence-based programs, and provides technical assistance on program selection, program start-up, outcome measurement, quality assurance, monitoring fidelity to the models, and data management and reporting. The Qii, which was piloted in 2009 and expanded in 2010, is a quality improvement process guided by National Center for Juvenile Justice staff in which program providers assess their current interventions and their outcomes. This information is used to generate a dynamic quality improvement plan to improve service delivery, short-term and long-term data collection issues, and eventually make data informed decisions about intervention improvements.

TENNESSEE: MANDATE "EVIDENCE-BASED" REQUIREMENTS FOR STATE FUNDING

In 2007, the Tennessee General Assembly passed a law requiring that state funds for juvenile justice programs or prevention and intervention programs could be expended only for programs that are evidence-based, as defined within the law. Pilot projects are allowed for evaluation purposes if they are supported by research or theory but lack the required number of research samples to be considered evidence-based. To minimize disruptions of existing programs, the funding requirement was phased-in. The first year, 25 percent of funding had to meet the requirement, and the threshold increases by 25 percent each year until 100 percent of funds meet the requirement. The Department of Children's Services, Administrative Office of the Courts, Tennessee Commission on Children and Youth, and provider representatives determine which of the existing programs meet the standards of the law and can be considered evidence-based.

WASHINGTON: USE COST BENEFIT ANALYSIS, WEIGH FUNDING PRIORITIES, AND REQUIRE PROGRAM DESIGN ELEMENTS

Since the mid-1990s, the Washington Legislature has directed the Washington State Institute for Public Policy (WSIPP) to estimate the costs and benefits of various evidence-based interventions and policy strategies, beginning with juvenile and criminal justice reviews. WSIPP developed an analytical tool for modeling changes in the juvenile justice system and the impacts on cost and crime. It has partnered with the Pew Center on the States, a nonpartisan research group, to share this tool with other states.

In 2009, the Washington Legislature charged a committee of stakeholders with crafting a new funding formula for distributing state dollars to the state's juvenile courts. The new formula was to emphasize evidence-based programs and alternatives that divert youth from confinement. The final version included formula weighting for the use of evidence-based programs, but also included other factors such as the assessed risk level of the juvenile court population.

The committee also developed a protocol for the use of state dollars for "promising programs" that may not have sufficient evidence to be "evidence-based" but meet a need of the juvenile justice population, and are based in research or delinquency theory. "Promising program" proposals must include a program manual, logic model, implementation strategy, and quality assurance infrastructure with measures to maintain fidelity to the design. The programs must also be evaluated at some point using a rigorous research design and cost-benefit analysis.

PROGRAM DESIGN AND EVALUATION IN TEXAS JUVENILE JUSTICE

Juvenile probation departments are funded through a mix of local, state, and federal funding. The state establishes standards and requirements for the using state funds, but program design and implementation are controlled locally. Some local departments have the resources and expertise to perform sophisticated program design and evaluation, while others do not.

In Texas, when youth are assigned to supervision, a case plan is developed, and some youth are assigned to receive programs or services in addition to basic supervision. One of the first steps in effectively assigning youth to programs or services is assessing their risks and needs. In fiscal year 2010, TJPC developed a Risk and Needs Assessment (RANA) tool in response to legislation requiring all juvenile probation departments to use a risk assessment before the disposition of a child's case.

Before this legislation, most departments did not use an assessment to determine risk of re-offense or their need for services. Instead, departments would collect a social history of the youth and present this information to the judge. While professional judgment is important, it can be difficult to estimate the significance of various factors to accurately predict chronic offending. Having a statistically validated risk assessment can help departments target intensive resources toward higher risk youth. Research has shown that actuarial instruments better predict human behavior than clinical or professional judgment, and suggests that treatment intensity should be generally matched to risk level. In certain cases, treating low-risk offenders with intensive services can actually increase recidivism. Having a baseline risk level quantified also provides for better program evaluation, because evaluators could compare actual chronic offending rates to those predicted by the risk assessment. Evaluators can also statistically control for the proportion of high- or low-risk offenders in a program, so that programs serving mostly low-risk youth are not compared with those targeted to high-risk youth. Some counties now use the RANA developed by TJPC, while others use tools developed elsewhere. The TJPC-developed RANA categorizes youth by risk level (e.g., low, medium, or high risk) for becoming chronic offenders based on predictive factors that have been statistically validated. The system's needs assessment also categorizes youth as having either low, medium, or high needs.

With the exception of the Juvenile Justice Alternative Education Programs, juvenile probation boards and departments often can choose which programs to implement. According to TJPC, more than 1,494 community-based programs are offered across the state. For fiscal year 2011, 30,413 juveniles on deferred prosecution or probation supervision participated in at least one program. Additionally, 5,606 juveniles participated in a program before the disposition of their case.

Departments also can choose how they evaluate their programs. While administrative standards exist for case management practices and local facility operations, there are few state-defined standards for what elements a program must have or how the program will be evaluated.

This choice, coupled with variations in resources and expertise, contributes to differing levels of sophistication in program design and evaluation across the state. For example, of 19 large- and medium-sized departments interviewed, 37 percent said only some of their programs have logic models or written frameworks, and 21 percent said none of their programs had either of these. While 79 percent of these departments said they were using at least one "evidence-based" program, several of them did not have a clear process in place for maintaining fidelity to the model. Most of these departments said they evaluated at least some of their programs, but their definitions of evaluation ranged from using regression analysis to assess impact to reviewing a provider's progress report on a juvenile. One department representative indicated that staff did not evaluate any of their programs. Some departments interviewed had staff dedicated to research and analysis, others partnered with universities or other entities for evaluations, and some relied on staff observation as part of their regular duties to judge program effectiveness. Technology resources vary as well; 53 percent of the counties interviewed used only software distributed by the state—either Caseworker or the new Juvenile Case Management System (JCMS). Both software packages have been available free of charge to most

departments from TJPC and now TJJD. Only 37 percent of these counties used Microsoft Excel, Microsoft Access, or SPSS to track program outcomes. Observation and feedback by clients and staff are important for making decisions about programs and should be considered, but comparisons over time and between programs might be improved with more objective data-driven analysis where feasible.

The state has an interest in comparing similar programs serving similar youth across departments to determine what programs are working best with youth across Texas. TJJD's Strategic Plan for 2013–2017 discusses targeting future funding based on a state evaluation of juvenile probation programs. However, TJJD lacks certain data necessary to assess the comparative effectiveness of local probation departments' programs.

Currently, monthly reports that departments submit to TJJD through the Electronic Data Interchange system can capture some program outcome data such as completion status and recidivism. In these monthly reports, departments must assign their program to one of 34 program types, but these reports do not capture needed information to account for variations in the structure between programs listed as the same program type. For example, while the actual program start and end date are captured for a particular youth, the intended length of the program is not captured. A three-week mentoring program is likely very different from a six-month mentoring program, and it may or may not be appropriate to compare their outcomes.

To capture more data on program structures, TJPC began building a Program and Services Registry in 2011. However, the program registry is incomplete; several departments acknowledged that information in the registry needed to be updated and that some of their programs were not listed in the registry. However, even the completion of the registry will not provide the departments with the ability to evaluate their own programs to identify problems and correct them. If TJJD begins considering program effectiveness in funding decisions, departments will still be at risk of losing funding opportunities if they cannot identify and address issues with less effective programs.

According to TJJD's Strategic Plan for 2013–2017, part of the mission of the new agency is to promote "positive youth outcomes through evidence-based performance and accountability that produces results." However, the current training schedule does not yet reflect or support that priority. As of December 2012, none of the trainings currently planned or approved by TJJD focus primarily on training local probation departments to develop the infrastructure to measure program results consistently. The agenda for the Data Coordinator's 2012 conference includes a one-half hour session on Program Components, and a one-half hour session on Evaluating Program Effectiveness.

Given the discretion and responsibility departments have to manage programming for youth, and the impact on the state if they fail to do so effectively, it is important that local probation staff have adequate training and support. Rather than every department employing a full-time research specialist, resources may better be leveraged by having dedicated state employees provide in-depth consultations. These consultations could include training and technical assistance on best practices in program design, performance monitoring, and evaluation.

Recommendation 1 would include a rider in the introduced 2014–15 General Appropriations Bill to direct the use of 2 full-time-equivalent (FTE) positions and $150,000 in fiscal year 2014 and $144,000 in fiscal year 2015 from Strategy 5.1.1 Central Administration. The funds would be used to increase technical assistance for program design and evaluation for programs run by juvenile probation departments. Assistance should include, but not be limited to:

- visiting local juvenile departments to provide in-depth consultative technical assistance on program design, implementation, and evaluation;
- assisting juvenile probation departments in developing logic models for all programs;
- developing recommended performance measures by program type;
- facilitating partnerships with universities, community colleges, or larger probation departments to assist departments with statistical program evaluations where feasible;
- following current research on juvenile justice program design, implementation, and evaluation; and
- disseminating best practices to juvenile probation departments.

To facilitate openness and cooperation between the departments and these trainers, the trainers should not be responsible for monitoring departments' compliance with standards.

FISCAL IMPACT OF THE RECOMMENDATION

Recommendation 1 would direct TJJD to use 2 FTE positions and the requisite funds to provide technical assistance to local probation departments to improve their ability to assess the effectiveness of their programs. Because these resources would be within TJJD's budget, Recommendation 1 has no fiscal impact.

The introduced 2014–15 General Appropriations Bill includes a rider to implement Recommendation 1.

CONSOLIDATE STATE CRIMINAL COURT COSTS TO REDUCE COMPLEXITY AND CLARIFY OFFENDER OBLIGATIONS

Court costs and fees are assessments against a person convicted of a criminal offense. Texas assesses both state and local court costs, which are intended to help fund the state and local criminal justice system. Some court costs are directly related to the costs courts incur, but others fund services related to law enforcement, supervision, court-ordered treatments or actions, and a variety of other programs. Court costs also reimburse costs related to victim compensation, DNA testing, drug courts, trauma care, peace officer services, jury service, and indigent defense.

State criminal court costs and fees generate revenue for the state. From fiscal years 2008 to 2012, state court cost collections totaled $1.8 billion, or an average of $368.2 million per year. In fiscal year 2012, collections totaled $354.8 million. Approximately 63.5 percent of court cost revenues are deposited to General Revenue–Dedicated accounts, 28.7 percent are deposited to the General Revenue Fund and 7.7 percent are deposited to Other Funds. Consolidating state criminal court costs and fees would reduce the administrative burden on local governments and possibly lead to improved collection rates.

FACTS AND FINDINGS

- ♦ Texas has 16 state criminal court costs that are deposited to 18 funds, including General Revenue Funds, General Revenue–Dedicated Funds, and Other Funds.
- ♦ Texas implemented partial consolidations of state court costs in fiscal years 1997 and 2004, but did not include every state court cost or fee. Since fiscal year 2004, additional separate court costs and fees have been authorized.
- ♦ State and local court costs and fees are listed in at least five statutory codes.
- ♦ Court costs and fees are only one piece of a defendant's potential court-ordered obligations, which can also include fines, monthly supervision fees, and victim restitution.
- ♦ The frequency of changes in or additions to the amounts charged for state court costs and fees varies. Some court costs remain unchanged for a number of years, while others are changed more frequently and new ones are added.
- ♦ Cash is the most common payment method used by defendants in paying court costs, fees, fines and other court-ordered obligations.

CONCERNS

- ♦ With at least 54 different state and local court costs and fees, having multiple state and local court costs and fees that vary by offense type and class is difficult for local entities to assess and collect.
- ♦ Having court costs and fees listed in multiple statutory code makes it more difficult for local governments, state agencies, and the public to understand and monitor changes to court costs and fees.
- ♦ The unpredictable nature of changes to amounts charged for court costs and fees increases confusion on the correct assessment amount at the local level and may also lead to larger increases during a short period, which increases the financial obligation placed on the defendant.
- ♦ Local court personnel indicated that uneven dollar amounts make payment collections more difficult when cash is the most common payment method.
- ♦ Other than a list of fees that is amended biennially, the state lacks a formal process to educate cities and counties about changes to these assessments.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Amend statute to consolidate all state criminal court costs and fees into one assessment per offense class for ordinance violations, Class C misdemeanors, Class A/B misdemeanors, and felonies.
- ♦ **Recommendation 2:** Amend statute to consolidate all state and local criminal court costs and fees into one statutory code.
- ♦ **Recommendation 3:** Amend statute to authorize a cost of living indexing feature to be added to the state consolidated court cost and include a requirement

that all state court costs and fees be set in even dollar amounts. The Texas Judicial Council would be authorized to adjust the consolidated court cost if certain criteria are met.

- ♦ **Recommendation 4:** Include a rider in the 2014–15 General Appropriations Bill providing four full-time equivalents to the Office of Court Administration and directing the agency to provide training to judges, clerks and other court personnel on court costs and fees.

DISCUSSION

In Texas, state and local criminal court costs and fees are used to help fund the judicial and criminal justice systems and are intended to partially reimburse jurisdictions for the costs of processing a criminal case. The court costs and fees assessed upon a conviction of a crime are different from a fine, which is the monetary penalty for committing a crime.

Court costs and fees are only assessed upon conviction of an offense. Class offenses include:

- Violations of municipal ordinances;
- Class C misdemeanors (includes most traffic violations);
- Class A/B misdemeanors; and
- Felonies.

Convictions, for the purposes of the assessment of court costs, can include plea arrangements, trials by judge or jury, deferred adjudication, and a variety of classifications specific to the level of court handling a case. In fiscal year 2012, there were 5.1 million convictions that would be eligible for court cost assessment. **Figure 1** shows the number of convictions for each classification.

FIGURE 1
NUMBER OF CRIMINAL CONVICTIONS BY OFFENSE CLASS LEVEL
FISCAL YEAR 2012

OFFENSE CLASS	CONVICTIONS
Ordinance/Parking	245,099
Class C	4,516,748
Class A/B	329,512
Felony	157,446
Total	**5,248,805**

SOURCES: Legislative Budget Board; Office of Court Administration.

Criminal cases are initially processed by local trial level courts, which include municipal, justice, county, and district courts. Each of these court types has a different jurisdiction over offense types and levels, and hears civil cases. Within criminal offenses, municipal courts typically handle municipal ordinance and Class C misdemeanor violations, many of which are traffic related. Justice courts also handle Class C misdemeanors. County courts process most of the Class A and B misdemeanors, with felony cases being handled by district courts. **Figure 2** shows the structure of Texas courts and the types of cases they process.

COURT COST OVERVIEW

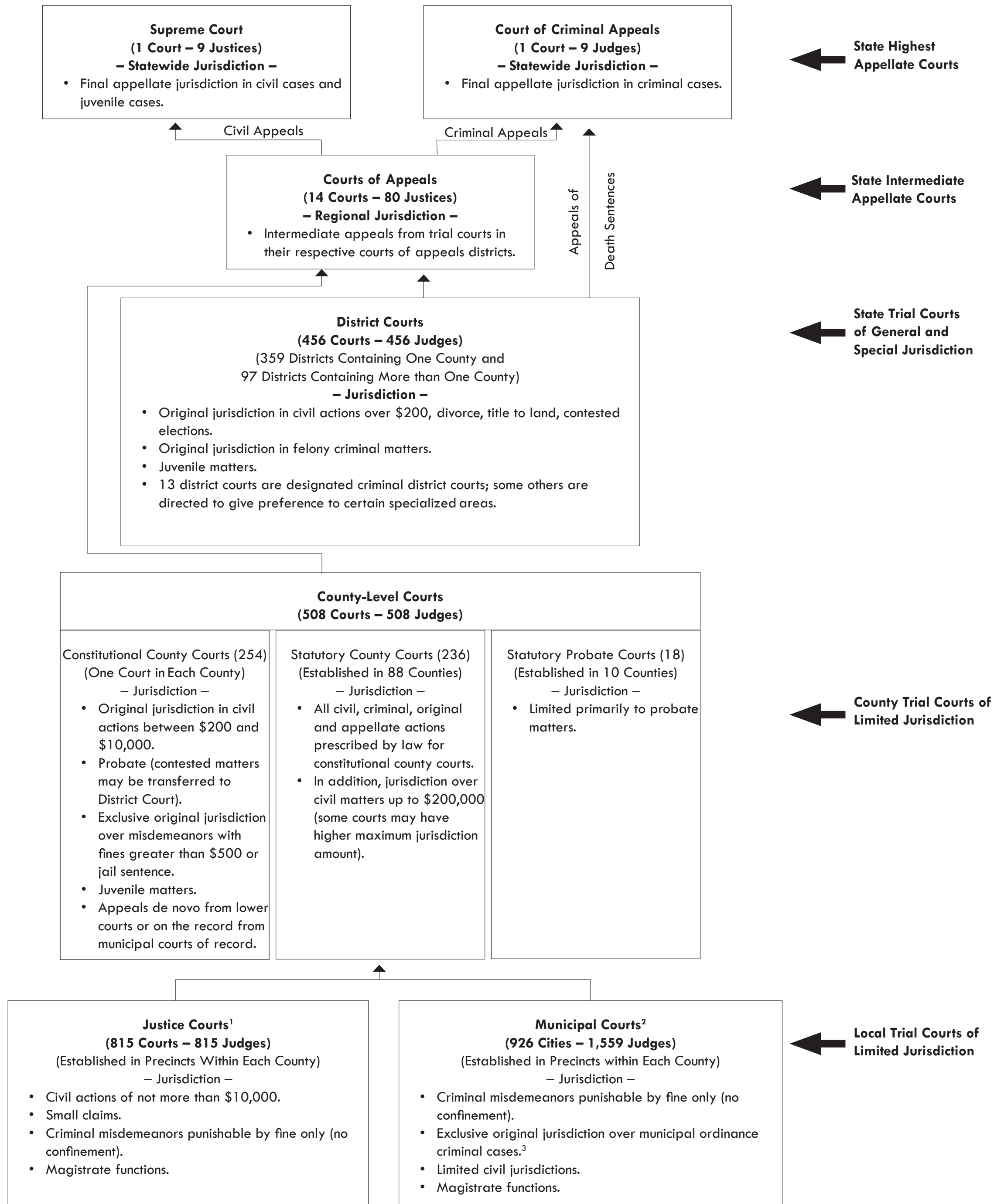
Court costs are intended to help reimburse the state and local governments for the cost of administering a criminal justice system. Some of these court costs are directly related to the costs courts incur, but they also fund services related to law enforcement, supervision, court-ordered treatments or actions, and a variety of other related items. Court costs attempt to reimburse some of the costs related to:

- victim compensation;
- DNA testing,
- drug courts;
- trauma care;
- peace officer services;
- jury service; and
- indigent defense.

Figure 3 provides a list of the major state court costs and fees with their amounts and purpose.

As **Figure 3** shows, there are 16 state criminal court costs detailed in five statutory codes. The revenue from these is allocated among 18 funds, including General Revenue Funds, General Revenue–Dedicated Funds, and Other Funds. **Figure 4** shows the allocation of revenues by fund and fee for fiscal year 2012. Approximately 63.5 percent of criminal court cost and fee revenue is deposited to General Revenue–Dedicated accounts; 28.7 percent to the General Revenue Fund; and 7.7 percent to Other Funds.

FIGURE 2
COURT STRUCTURE OF TEXAS AS OF SEPTEMBER 1, 2012



[1]All justice courts and most municipal courts are not courts of records. Appeals from these courts are by trial de novo in the county-level courts and in some instances in district courts.
[2]Some municipal courts are courts of record—appeals from those courts are taken on the record to the county-level courts.
[3]An offense that arises under a municipal ordinance is punishable by a fine not to exceed: (1) $2,000 for ordinances that govern fire safety, zoning, and public health, or (2) $500 for all others.
SOURCE: Office of Court Administration.

FIGURE 3
STATE CRIMINAL COURT COSTS AND FEES, SEPTEMBER 2012

COURT COST/FEE	AMOUNT	PURPOSE/USE OF COST/FEE	TEXAS STATUTE	STATE/LOCAL REVENUE SPLIT
Consolidated Court Cost	$40 – Class C $83 – Class A/B $133 – Felony	Consolidates a group of previous court costs into one cost.	Local Government Code, Section 133.102(a)	90% State 10% Local
DNA Testing	$34 – Community supervision $50 – Misdemeanor $250 – Felony	Applied to specific offenses, most of which are sexual assault or related crimes. 35% deposited to state highway system fund and 65% deposited to criminal justice planning fund.	Code of Criminal Procedure, Section 102.020	90% State 10% Local
Driving Record Fee	$12	Optional fee for obtaining a copy of a defendant's driving record.	Code of Criminal Procedure, Section 45.0511(c-1)	100% State 0% Local
Drug Court Program Fee	$60	To provide support for court-administered drug court programs. State receives 90% of fee when county does not have an established drug court program.	Code of Criminal Procedure, Section 102.0178	90% State 10% Local
EMS Trauma Fund	$100	Used for emergency medical services and trauma facilities.	Code of Criminal Procedure, Section 102.0185	90% State 10% Local
Failure to Pay/ Appear/ Satisfy Judgment Fee	$30	State receives $20 from fee.	Transportation Code, Section 706.006(a)	$20 State $10 Local
Indigent Defense	$2	To provide support for indigent defendants. State receives 90% of fee.	Local Government Code, Section 133.107	90% State 10% Local
Judicial Support Fee	$6	Provides court-related support.	Local Government Code, Section 133.105(a)	90% State 10% Local
Jury Reimbursement Fee	$4	Reimburses cost for jurors	Code of Criminal Procedure, Section 102.0045	90% State 10% Local
Juvenile Probation Diversion Fund Court Cost	$20	Charged per disposition hearing.	Family Code, Section 54.0411	90% State 10% Local
Moving Violation Fee	$0.10	For moving violations; remitted to the state for the Civil Justice Repository Fund.	Code of Criminal Procedure, Section 102.022	90% State 10% Local
Peace Officer Services	$5 – Arrest $5 – Notice to Appear $50 – Warrant	Payment for peace officer services; state receives 20% when performed by state personnel.	Code of Criminal Procedure, Section 102.011(a)	20% State 80% Local
Restitution Installment Fee	$12	Optional one-time fee charged when a defendant is required to make restitution in specified installments.	Code of Criminal Procedure, Section 42.037	50% State 50% Local
State Traffic Fine	$30	Designated for state trauma facilities and emergency care.	Transportation Code, Section 542.4031	95% State 5% Local
County Courts Salary Supplement	$15	Used by the state to pay annual salary supplements to county-level judges.	Government Code, Section 51.702, and Section 51.703	100% State 0% Local
Time Payment Fee	$25	Paid when a defendant cannot pay costs in full within 31 days after judgment. State receives 50% of fee.	Local Government Code Section 133.103	50% State 50% Local

Sources: Legislative Budget Board; Comptroller of Public Accounts; Office of Court Administration.

FIGURE 4
STATE CRIMINAL COURT COST AND FEE REVENUE ALLOCATION BY FUND AND COURT COST OR FEE, FISCAL YEAR 2012

FUND	COST OR FEE BY TYPE	REVENUE CODE	REVENUE	PERCENTAGE OF REVENUE
GENERAL REVENUE FUND (0001)				
	Consolidated Court Cost	3713	$16,239	0.0%
	Drug Court Program	3704	2,307,573	0.7%
	Failure to Appear	3793	11,986,211	3.4%
	Juror Reimbursement Fees	3704	16,822,601	4.7%
	Juvenile Probation Diversion	3704	118,323	0.0%
	Moving Violations	3704	260,562	0.1%
	Peace Officer Services	3706	1,276,331	0.4%
	Seat Belt/Child Safety	3704	7,481	0.0%
	State Traffic Fine (67%)	3710	58,519,211	16.5%
	Time Payment	3801	10,668,376	3.0%
Total, General Revenue Funds			**$101,982,908**	
GENERAL REVENUE–DEDICATED FUNDS				
Operator's and Chauffeur's License (0099)	Consolidated Court Cost	3704	$20,630,952	5.8%
Comprehensive Rehabilitation (0107)	Consolidated Court Cost	3704	18,007,917	5.1%
Law Enforcement Officer Standards and Education (0116)	Consolidated Court Cost	3704	9,257,183	2.6%
Criminal Justice Planning (0421)	Consolidated Court Cost	3704	23,244,108	6.6%
Criminal Justice Planning (0421)	DNA Testing (65%)	3704	116,471	0.1%
Crime Victims' Compensation (0469)	Consolidated Court Cost	3704	69,638,383	19.6%
Crime Victims' Compensation (0469)	Restitution Installment Fee	3801	6,658	0.0%
Judicial & Court Personnel Training Fund (0540)	Consolidated Court Cost	3704	8,917,672	2.5%
Bill Blackwood Law Enforcement Management Institute (0581)	Consolidated Court Cost	3704	4,005,830	1.1%
Crime Stoppers Assistance (5012)	Consolidated Court Cost	3704	480,254	0.1%
Breath Alcohol Testing (5013)	Consolidated Court Cost	3704	1,019,973	0.3%
Center/Study of Juvenile Crime (5029)	Consolidated Court Cost	3704	2,219,033	0.6%
Fair Defense (5073)	Consolidated Court Cost	3704	14,644,375	4.1%
Fair Defense (5073)	Indigent Defense	3704	8,123,811	2.3%
Correctional Management Institute (5083)	Consolidated Court Cost	3704	2,210,292	0.6%
EMS, Trauma Facilities, Trauma Care (5108)	EMS Trauma	3704	3,830,029	1.1%
Trauma Facility & EMS (5111)	State Traffic Fine (33%)	3710	28,822,895	8.1%
Emergency Radio Infrastructure (5153)	Consolidated Court Cost	3704	10,136,111	2.9%
Total, General Revenue–Dedicated Funds			**$225,411,779**	
OTHER				
State Highway Fund (0006)	DNA Testing (35%)	3704	$116,471	0.0%
Judicial Fund (0573)	Judicial Fund Fee	3704	2,446,607	0.7%
Judicial Fund (0573)	Judicial Support	3704	24,806,218	7.0%
Total, Other Funds			**$27,369,296**	

FIGURE 4 (CONTINUED)
STATE CRIMINAL COURT COST AND FEE REVENUE ALLOCATION BY FUND AND COURT COST OR FEE, FISCAL YEAR 2012

FUND	COST OR FEE BY TYPE	REVENUE CODE	REVENUE	PERCENTAGE OF REVENUE
	GENERAL REVENUE FUNDS		$101,982,908	28.7%
	GENERAL REVENUE–DEDICATED FUNDS		225,411,779	63.5%
	OTHER FUNDS		27,369,296	7.7%
	FEDERAL FUNDS		-	0.0%
	GRAND TOTAL, ALL FUNDS		**$354,763,982**	**100.0%**

Sources: Legislative Budget Board; Comptroller of Public Accounts.

LOCAL ISSUES WITH ASSESSMENT AND COLLECTION

Some court costs and fees are always assessed upon a conviction, such as the consolidated court cost. Others are charged depending on the offense or the circumstances of the case, such as the DNA testing court cost or the time payment fee.

A March 2009 report by the Office of Court Administration (OCA) and the Council of State Governments Justice Center identified that the number of state and local court costs and fees for criminal convictions makes it difficult for local courts to administer. According to OCA, as of September 2011, there are 54 state and local court cost and fee assessments for criminal convictions in numerous combinations among the four trial court levels.

A 2012 Legislative Budget Board (LBB) staff survey of local government personnel revealed concerns about the numbers of fees and the difficulty in ensuring that the correct amount is charged for each conviction. LBB staff conducted 14 interviews with 13 unique jurisdictions and electronically surveyed 199 staff members at 91 cities and counties that serve in various courts and collection-related offices; 90 local staff members completed the survey. When asked if consolidating state court costs would be helpful, 49 percent responded that it would be; 41 percent were neutral; and less than 10 percent responded that it would not be helpful.

The state previously consolidated some court costs to simplify and improve the local administrative burden of administering court costs and fees. A major consolidation, effective September 1997, included 10 previously separate court costs which were consolidated into one assessment. Further consolidation, effective January 2004, added four more costs into the consolidated court cost. While these two consolidations reduced the number of court costs, the process was incomplete because certain fees were not included during those consolidations, such as the time payment fee, and additional fees have been added since that time, such as the drug court program fee.

Recommendation 1 would amend the Texas Local Government Code, Section 133.102(a), to fully consolidate all state criminal court costs and fees into one assessment per offense class. The recommended amounts for each assessment are shown in **Figure 5**. These assessments would apply to all offenses.

FIGURE 5
RECOMMENDED AMOUNTS FOR CONSOLIDATED COURT COST

OFFENSE CLASS	COURT COST
Ordinance/Parking/Pedestrian	$30
Class C	$122
Class A/B	$160
Felony	$185

Note: The recommended amounts for each assessment are based on fiscal year 2012 revenues and 2012 reported conviction statistics. According to OCA, the Class C numbers reported by courts in 2012 may be underreported.
Source: Legislative Budget Board.

Consolidating court costs into one assessment per offense class will require revising the allocation of the current consolidated court cost to include all the funds currently receiving state criminal court costs revenue. The revised allocations should be consistent with the percentage of court cost and fee revenues each fund now receives when local entities remits the amounts to the state. The recommended allocation of revenues for the revised consolidated court costs are shown in **Figure 6**. This allocation is based on fiscal year 2012 revenues.

A parallel issue to the number of state and local criminal court costs is the number of statutory references for state and local criminal court costs and fees. State criminal court costs

FIGURE 6
RECOMMENDED ALLOCATION FOR NEW CONSOLIDATED COURT COST BY FUND

FUND	NUMBER	ALLOCATION (PERCENTAGE)
General Revenue Fund	0001	28.7467
State Highway Fund	0006	0.0328
Comprehensive Rehabilitation	0107	5.0760
Law Enforcement Officer Standards and Education	0116	2.6094
Criminal Justice Planning	0421	6.6130
Compensation to Victims of Crime	0469	19.6314
Judicial and Court Training Personnel	0540	2.5137
Judicial Fund	0573	7.6820
Bill Blackwood Law Enforcement Institute	0581	1.1292
Law Enforcement and Custodial Officer Supplemental Retirement	0977	5.8154
Crime Stoppers Assistance	5012	0.1354
Breath Alcohol Testing	5013	0.2875
Center for the Study of Juvenile Crime	5029	0.6255
Fair Defense	5073	6.4178
Correctional Management Institute	5083	0.6230
EMS, Trauma Facilities, Trauma Care	5108	1.0796
Trauma Facility and EMS	5111	8.1245
Emergency Radio Infrastructure	5153	2.8571

Note: Allocation for Fund 977 replaces Fund 99 due to 2011 legislation.
Source: Legislative Budget Board.

and fees are included in 17 sections of five different statutory codes. Local court costs and fees add to that number. Having so many references in statute to criminal court costs and fees makes it difficult for state officials, local officials, and the general public to identify and understand the array of fees that can be assessed.

To increase transparency and simplify the process of locating court costs and monitor changes to them, Recommendation 2 would amend the Texas Local Government Code to include all state and local criminal court costs and fees into one statutory code. It is recommended that all state court costs be contained within the Texas Local Government Code, Chapter 133, as detailed in Recommendation 1, and that local court costs and fees be contained within their own chapter in the same statutory code.

INDEXING COURT COSTS TO INFLATION

The frequency at which state and local court costs are amended is inconsistent. As shown in **Figure 7**, some court costs and fees were amended recently, but others have remained at the same level for a number of years. For example, the consolidated court cost has not be amended by legislation since 2003, while the drug court cost was initially authorized in 2007, and increased by $10 in 2009.

Three court costs, including the consolidated court cost, were last amended by legislation enacted in 2003. Of the 16 state criminal court costs and fees, three were amended as recently as 2009. The remaining 13 have not been amended in at least six years.

From the defendant perspective, criminal court costs and fees represent one piece of the financial obligations that defendants can incur upon conviction. One policy consideration for potential court-ordered obligations is to prevent sizable increases over a short period due to the difficulty defendants have in paying obligations. In addition to court costs, other defendant obligations can include fines, supervision fees, attorney fees and restitution. Responses to the LBB staff survey on court costs indicate that many defendants struggle to pay their court-ordered obligations. Of survey respondents, 85 percent selected unemployment as an issue and 84 percent of respondents selected low income

FIGURE 7
RECENT CHANGES TO COURT COSTS AND FEES, SEPTEMBER 2012

COURT COST OR FEE	AMOUNT	AUTHORIZED	MOST RECENT FEE AMOUNT CHANGE
Consolidated Court Cost	$40 – Class C $83 – Class A/B $133 – Felony	First consolidation 1997 Second consolidation 2003	2003
DNA Testing	$34 – Probation $50 – Misdemeanor $250 – Felony	2001	2009
Driving Record Fee	$12	2005	2007
Drug Court Program Fee	$60	2007	2009
EMS Trauma Fund	$100	2003	2003
Failure to Pay/Appear/Satisfy Judgment Fee	$30	1997	1997
Indigent Defense	$2	2007	2007
Judicial Support Fee	$6	2005	2007
Jury Reimbursement Fee	$4	2005	2005
Juvenile Probation Diversion Fund Court Cost	$20	1987	1987
Moving Violation Fee	$0.10	2009	2009
Peace Officer Services	$5 – Arrest $5 – Notice to Appear $50 – Warrant	1987	1999
Restitution Installment Fee	$12	2005	2005
State Traffic Fine	$30	2003	2003
Judicial Support Fund/County Courts Supplement	$15	1991	1995
Time Payment Fee	$25	2003	2003

Note: Authorization and/or change date indicates year of enacting legislation. Effective date may have been later (frequently effective dates are January 1 of the following year).
Source: Legislative Budget Board.

as an issue. From the local government perspective, inconsistent changes in court costs and fees can be a challenge to implement due to system programming and the need to maintain historical records to charge appropriate amounts based on the date of the offense committed.

Court costs and fees would be more effective if they were structured to maintain their purchasing power relative to the types of local and state costs they are intended to cover. However, given the administrative impact that these changes have on local government, the changes would be easier for local governments to implement if they occur on a more predictable schedule.

To maintain the purchasing power of courts costs with predictable, modest increases, Recommendation 3 would amend the Texas Local Government Code, Chapter 133, to authorize a cost of living increase to the consolidated court cost every four years, but only if no other increases to the amount assessed are made during each four-year period and if the inflation rate is 3 percent or more during that time. Statute would identify the Texas Judicial Council, which is the policy-making body for the judiciary, as the entity responsible for adjusting the court cost amounts and OCA would be responsible for posting and distributing information electronically to local courts to ensure they are informed of any upward adjustments to the court cost.

Local trial level courts accept a variety of payment methods at their clerk, collection, or other offices that process payments for court costs and other court-ordered obligations. In the LBB staff's survey, 47 percent of respondents answered that cash is the most common payment method, and another 32 percent said that money orders were the most common. Of survey respondents, 85 percent indicated that having state court costs in even dollars would make cash payments easier. As part of Recommendation 3, in addition to the cost of living indexing feature, the Texas Judicial Council would

be required to set any adjustment to the consolidated court cost in even dollar amounts to facilitate easier cash payments for the local entities collecting the payments.

FISCAL NOTES FOR LEGISLATION THAT MODIFIES STATE COURT COSTS

State and local court costs and fees are authorized in statute. Since historically these fees have resided in a variety of statutory codes, it has been difficult for legislative members, their staff, or any one working on defendant obligations to see the scope of those obligations. Implementing Recommendations 1 and 2 would improve the tracking of changes to court cost and fees. To improve the transparency of proposed changes to court costs, during the Eighty-third Legislature, 2013, LBB staff will include information in the fiscal note for proposed bills that have a significant state criminal court cost and fee impact. The fiscal notes will include information about the anticipated impact on court cost amounts for sample offenses.

TRAINING ON COURT COSTS AND FEES

The state does not require or provide comprehensive training to municipal and county court personnel about court costs and fees. The Texas Government Code, Section 51.607, requires the Comptroller of Public Accounts to publish a list of amended court costs and fees from criminal and civil cases. The most recent list, published in 2011, was a one-page summary of the court cost and fee amendments enacted by the Eighty-Second Legislature.

OCA publishes court cost charts for each trial court level, including municipal, justice, county and district courts. The agency also offers historical court cost handbooks.

OCA serves as a resource to courts on court costs and fees. Within OCA's Collection Improvement Program (CIP), staff also offer informal training on court costs and fees to the local entities participating in CIP as part of the broader objective of establishing effective collection practices.

The current state and local court cost and fee assessment for criminal convictions can result in 54 costs and fees in numerous combinations among the four trial court levels. OCA staff identified incidents where the same criminal conviction is not assessed the same court costs and fees by different jurisdictions. Even if state court costs are consolidated into one assessment, there are differences in how court costs and fees must be assessed or processed at each court level. In the LBB staff survey, 62 percent of respondents indicated that more comprehensive training on court-ordered obligations would be helpful.

To address the training needs related to court costs and fees for local court personnel, Recommendation 4 would include a rider in the introduced 2014–15 General Appropriations Bill directing OCA to develop and provide training to judges, clerks, and other court personnel on court costs, fees, and other court-ordered financial obligations. These 4 full-time-equivalent (FTE) positions would include a program manager, two training specialists, and a program specialist to develop curriculum, prepare publications and materials, and offer in person and webinar based trainings to the all regions throughout the state.

FISCAL IMPACT OF THE RECOMMENDATIONS

The recommendations, if implemented, would result in a net gain of $2 million in General Revenue Funds and General Revenue–Dedicated Funds for the 2014–15 biennium. **Figure 8** shows the five-year fiscal impact of the recommendations. Recommendation 2 would not have a fiscal impact.

Recommendation 1, the consolidation of state criminal court costs into one assessment by offense class, would result in a gain of $0.8 million in General Revenue Funds and $2.7 million in All Funds for the 2014–15 biennium. The new court costs assessment would be set at amounts that would be close to revenue neutral, after accounting for costs associated with Recommendation 4. The recommended court cost assessment amounts are based on fiscal year 2012 convictions. According to OCA, the Class C misdemeanors may not be accurate due to a reporting change for the courts.

Recommendation 3, indexing court costs to inflation through periodic adjustments if needed, would have a fiscal impact. The estimates for this report assume modest increases to the new court cost assessment amounts at four-year intervals. From this recommendation the state would not realize a revenue gain during the 2014–15 biennium but would have an estimated gain of $3.3 million in General Revenue Funds and $11.6 million in All Funds in fiscal year 2018, assuming the consolidated court cost is increased by 3 percent and rounded to the nearest dollar amount for each offense class.

Recommendation 4, increasing training efforts on court costs and fees by the state through assigning responsibility to OCA, would cost $504,310 in General Revenue Funds for the 2014–15 biennium. This cost includes adding 4 FTE

FIGURE 8
FIVE-YEAR FISCAL IMPACT, FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE SAVINGS/ (COST) IN GENERAL REVENUE FUNDS	PROBABLE REVENUE GAIN/(LOSS) IN GENERAL REVENUE FUNDS	PROBABLE REVENUE GAIN/(LOSS) IN GENERAL REVENUE–DEDICATED FUNDS	PROBABLE REVENUE GAIN/(LOSS) IN OTHER FUNDS	PROBABLE ADDITION/ (REDUCTION) OF FULL-TIME-EQUIVALENT POSITIONS
2014	($208,306)	$391,991	$866,414	$105,199	4.0
2015	($296,004)	$391,991	$866,414	$105,199	4.0
2016	($287,552)	$391,991	$866,414	$105,199	4.0
2017	($287,552)	$391,991	$866,414	$105,199	4.0
2018	($287,552)	$3,739,767	$8,265,969	$1,003,647	4.0

Source: Legislative Budget Board.

positions at OCA to develop and deliver training to court personnel at local trial level courts on court costs, fees, and other court-ordered financial obligations. The estimate assumes there would a partial year lag in fiscal year 2014 as the program is initially implemented.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

FUND THE STATE WATER PLAN TO ENSURE ADEQUATE FUTURE WATER SUPPLIES

The State Water Plan is developed by 16 designated regional planning groups in conjunction with the Texas Water Development Board. The plan contains 562 water management strategies whose purpose is to ensure adequate water supplies for Texas during a drought. Proposed water management strategies include the construction of new reservoirs, water reuse facilities, and increased water conservation.

According to the State Water plan, a significant increase in water supply is needed to sustain Texas' economy and population during a severe drought. According to State Water Plan estimates, the projected cost to address future water supply shortages from 2012 to 2060 is $53.1 billion. The state share requested by the regional planning groups in the State Water Plan is approximately $26.9 billion. Existing state funding for water management strategies relies primarily on General Obligation bond issuances that finance loans to local and regional water suppliers. Loans are issued via several programs, primarily the Water Infrastructure Fund, which has issued close to $1 billion in General Obligation bonds since 2008. Given a projected 82 percent state population increase by 2060, an aging water supply infrastructure, and recent experiences with drought conditions, additional state funding for State Water Plan initiatives is warranted. Options for funding these strategies include additional appropriations of General Revenue Funds, implementing a water usage fee, increasing an existing fee, and repealing the sales tax exemption on bottled water.

FACTS AND FINDINGS

- ♦ The Texas Water Development Board has typically issued General Obligation bonds to fund State Water Plan projects. The debt service on these bonds is initially funded via appropriations of General Revenue Funds. As each bond issuance matures, loan repayments fully cover each issuance's annual debt service. In keeping with this financing methodology, the State Water Plan is projected to cost the state approximately $8.6 billion to fund debt service obligations for $26.9 billion in local financial assistance.
- ♦ A revolving loan fund is a loan mechanism whereby the central balance of the fund is replenished as individual projects pay back their loans, creating the opportunity to issue other loans to new projects. By capitalizing a revolving loan account with, for example, $150 million annually for 15 years, the cost would be approximately $2.3 billion during the same period.

CONCERNS

- ♦ Texas does not have sufficient water during a drought to maintain supplies to all areas of the state. Should strategies not be implemented to maintain sufficient water supplies, there could be substantial social and economic consequences. The effects of this could translate into losses of income, jobs, population growth, and subsequent losses in local and state tax revenue.
- ♦ Texas lacks a consistent, long-term source of dedicated revenue to ensure a sufficient water infrastructure.
- ♦ In Texas, the price of water primarily reflects supply costs, and not the intrinsic value of water as a finite resource. As a result, there is no disincentive to discourage consumers from over-use.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Amend statute to establish a dedicated fund for the deposit of money to be used in financing State Water Plan projects.
- ♦ **Recommendation 2:** Fund the State Water Plan to maintain sufficient water supplies in the state. Revenue could come from one or a combination of these options:
  - ◦ **Option 1:** Amend statute to allocate one-half of revenue generated from the miscellaneous gross receipts tax that would have otherwise been deposited to the General Revenue Fund.
  - ◦ **Option 2:** Amend statute to implement a statewide water usage fee on water sold by community water suppliers. The fee would correlate to the level of water consumption by individual users, incentivizing an increase in water conservation.

- **Option 3:** Amend statute to codify and increase the Public Health Service Fee. Revenue above appropriations made to the Texas Commission on Environmental Quality for water resources management would be dedicated to funding State Water Plan projects.
- **Option 4:** Amend statute to repeal the sales tax exemption for bottled water.

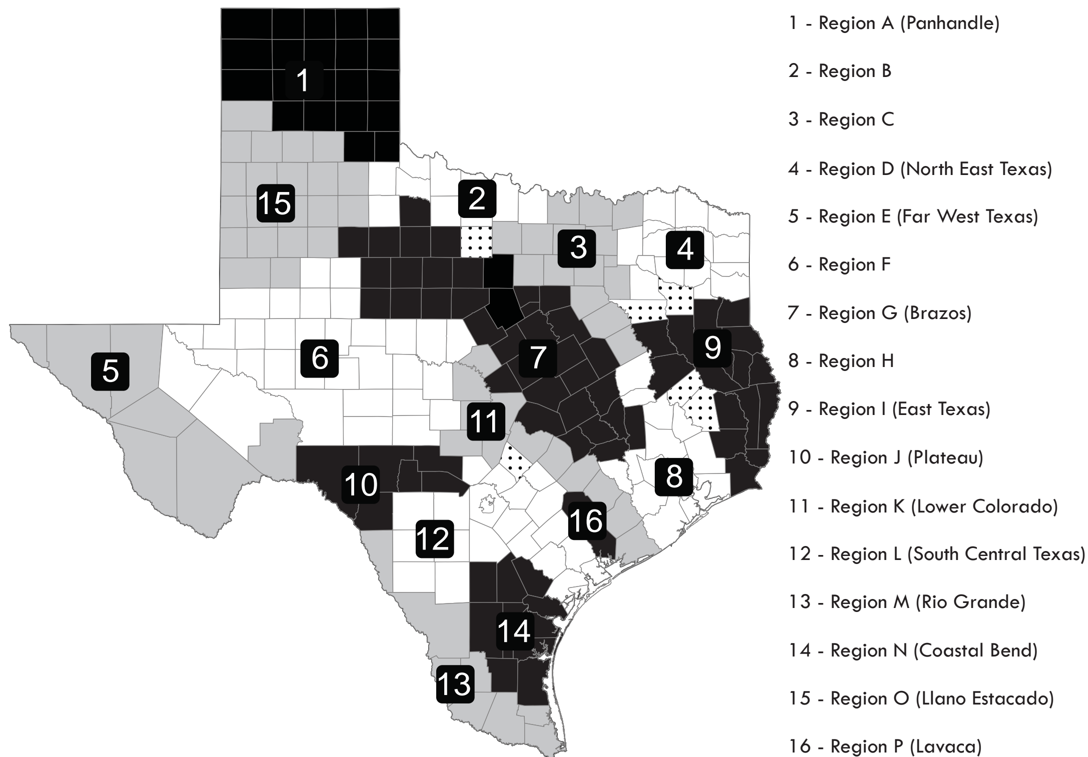
♦ **Recommendation 3:** Include a contingency rider in the 2014–15 General Appropriations Bill to appropriate revenue estimated to be collected from the option selected in Recommendation 2 to the Texas Water Development Board to fund State Water Plan projects.

DISCUSSION

Ensuring water supplies are available to meet future demand presents a significant challenge for Texas because sections of the water distribution infrastructure are more than 100 years old, and the state population is projected to increase 82 percent by 2060. The State Water Plan (SWP) is a planning document used to develop adequate water supplies for future times of drought. The SWP was developed by 16 designated regional planning groups, in conjunction with the Texas Water Development Board (TWDB). The SWP is revised every five years. The five-year state and regional water planning cycle is designed to address risks, uncertainties, and emerging needs in the state. The regional planning group's jurisdictions are shown in **Figure 1**. The process of drafting a water plan was initially formulated after what is now commonly known as the Drought of Record, which occurred in the 1950s.

The 2012 SWP states that, "In serious drought conditions, Texas does not and will not have enough water to meet the needs of its residents, its businesses, and its agricultural enterprises." According to an economic study contained in the SWP, annual economic losses from not meeting water supply needs could result in a reduction in income of approximately $11.9 billion in 2010. This assumes drought conditions were experienced statewide and SWP strategies were not implemented. Should this trend continue until

FIGURE 1
REGIONAL WATER PLANNING GROUPS, FISCAL YEAR 2012



Note: Dotted counties are split between multiple regions.
Source: Texas Water Development Board.

2060, losses are projected to reach $115.7 billion, with more than 1 million lost jobs.

During the 50-year planning period from 2010 to 2060, growth in population and economic activity is projected to increase water demand by 22 percent. This projection represents a growth in consumption from 18 million acre-feet per year in 2010 to 22 million acre-feet in 2060. An acre-foot is the volume of water needed to cover an area of one acre to a depth of one foot. Existing water supplies are projected to decrease about 10 percent during this period, from 17.0 million acre-feet in 2010 to 15.3 million acre-feet in 2060. This projected decrease is due primarily to Ogallala Aquifer depletion and reduced reliance on the Gulf Coast aquifer. The Ogallala, part of the High Plains aquifer system, is one of the largest aquifers in the world; spanning eight states and providing drinking water to approximately 82 percent of the population that resides above it. Reductions in Gulf Coast aquifer levels are due to mandatory reductions in pumping to prevent land subsidence. Without additional water supplies in place, Texas will have 8.3 million acre-feet less than is projected to be needed in 2060.

PROJECTED FUNDING REQUIREMENTS

Current state financial assistance for water-related projects is insufficient to meet the needs identified in the SWP. Project funding requirements in the SWP are the result of survey responses from water providers in each of the 16 regional planning groups. Of the 694 entities surveyed during the SWP regional planning process, 269 responded. These respondents indicated that estimated total future capital costs of $231 billion would be necessary to maintain or expand their infrastructure to meet projected water demands. These respondents represent all major metropolitan areas of the state.

In the 2012 iteration of the SWP, regional planning groups recommended implementing 562 unique water supply projects to meet water supply needs for Texas. If implemented, 9.0 million acre-feet in additional water supplies could be achieved by 2060 at a cost of $53.1 billion. Strategies include constructing new reservoirs, desalination plants, water recycling/reuse centers, and increasing water conservation efforts. It is anticipated that $6.9 billion will be funded directly by private entities and $19.3 billion from local governments. The SWP recommends that the state provide the remaining $26.9 billion in financial assistance to local water suppliers to fill this financing gap.

SWP costs correlate with projected population growth, primarily associated with the state's major metropolitan areas. The highest project costs are in the fastest growing and most densely populated regions of the state. Region C (Dallas-Fort Worth), Region H (Houston), and Region L (San Antonio) encompass 83 percent of all funding requests. Projected water demand and state financial assistance requested by region is shown in **Figure 2**.

As part of the survey process, respondents indicated the year in which they believe the proposed project would be needed. SWP projects are organized by their "decade of need;" a projection of when the demand for water will exceed available supplies. Funding for SWP projects organized by decade of need is shown in **Figure 3**. This figure, however, only accounts for strategies associated with obtaining a sufficient supply of water. Total capital costs to both state and local governments for supplemental strategies including $88.9 billion for water treatment and distribution, $81.7 billion for wastewater treatment and collection, and $7.5 billion for flood control culminates in a total cost of $231 billion by 2060. These additional strategies are, however, primarily contingent on the $53.1 billion in water supply enhancing strategies being implemented.

PRIMARY LOAN PROGRAMS

TWDB is the state agency primarily responsible for water planning and for administering water financing for the state. TWDB was established by legislation and constitutional amendment in 1957. TWBD operates several General Obligation (GO) and revenue bond programs that local entities can access. These programs are designed to assist in the maintenance of general infrastructure and water quality. Since 2008, the Texas Legislature has authorized approximately $1.7 billion in GO bond authority to TWDB to meet local water, wastewater, and flood control needs. For additional information regarding prior funding levels and program descriptions for water programs, refer to the Legislative Budget Board publication *State Funding for Water Programs*, Legislative Primer, January, 2011.

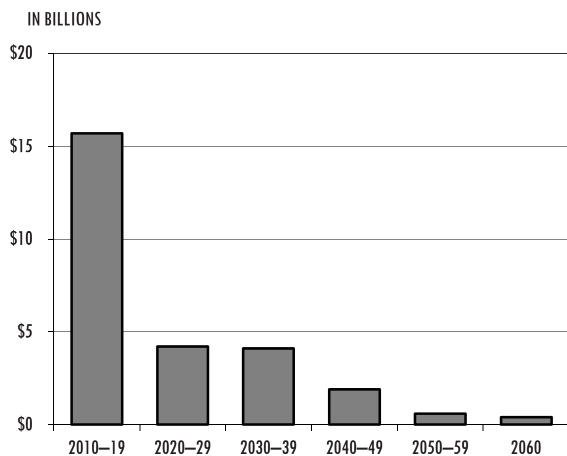
Loan programs able to be used for SWP project are the Water Infrastructure Fund (WIF), State Participation Program (SPP), and the Economically Distressed Areas Program (EDAP). A comparison of these programs is shown in **Figure 4**. The WIF was designed specifically for financing SWP projects and may issue either GO or revenue bonds. WIF loans are estimated to encompass 87 percent of financing demand for water-related projects. The SPP is able to issue

FIGURE 2
PROJECTED WATER DEMAND AND FINANCIAL ASSISTANCE NEEDED BY REGION

REGION	MAJOR CITY IN REGION	WATER MANAGEMENT STRATEGY SUPPLIES IN ACRE-FEET	WATER MANAGEMENT STRATEGY CAPITAL COST (IN MILLIONS)	FINANCIAL ASSISTANCE NEEDED (IN MILLIONS)	PERCENTAGE OF TOTAL FINANCIAL NEED
C	Dallas-Fort Worth	2,360,302	$21,482	$11,743	43.7%
H	Houston	1,501,180	12,019	7,142	26.6
L	San Antonio	765,738	7,623	3,517	13.1
G	Waco	587,084	3,186	1,153	4.3
A	Amarillo	648,221	739	624	2.3
F	Midland	235,198	915	593	2.2
E	El Paso	130,526	842	500	1.9
I	Beaumont	638,076	885	500	1.9
M	Brownsville	673,846	2,195	445	1.7
B	Wichita Falls	77,003	499	384	1.4
K	Austin	646,167	907	154	0.6
O	Lubbock	395,957	1,108	78	0.3
J	Kerrville	23,010	55	20	0.1
D	Longview	98,466	39	5	0.0
N	Corpus Christi	156,326	656	0	0.0
P	El Campo	67,739	0	0	0.0
Total		**9,004,839**	**$53,150**	**$26,858**	**100.0%**

Sources: Legislative Budget Board; Texas Water Development Board.

FIGURE 3
DEMAND FOR STATE FINANCIAL ASSISTANCE
FISCAL YEARS 2010 TO 2060



Source: Texas Water Development Board.

only GO bonds and is estimated to comprise demand for 11 percent and a combination of EDAP and WIF Rural Assistance would amount to 2 percent. These programs are codified in the Texas Constitution, Article III, Section 49, as well as in the Texas Water Code, Chapters 15, 16, and 17.

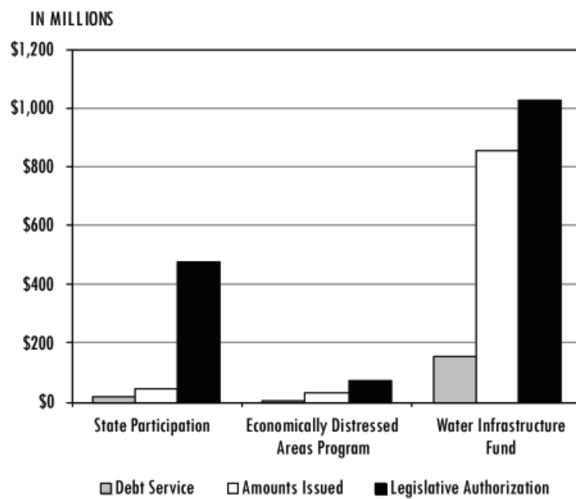
In general, funding for WIF is designed to help a political subdivision address existing water infrastructure needs. An example of this would be the construction of a new water plant to supply an existing customer base. The SPP is designed to address future water supply needs. The TWDB is able to assume a temporary ownership interest in projects financed through the SPP for a financing life of up to 34 years. Examples of SPP projects include construction of a new reservoir, laying higher capacity pipelines in lieu of lower capacity pipelines, or other projects designed to expand capacity in anticipation of growth in demand resulting from population growth. **Figure 5** shows General Revenue Fund appropriations for GO water bond debt service from 2008 to 2013. External factors that may affect the amount of bonds issued include the demand for financial assistance, readiness of recipients to proceed with their funded projects, and

FIGURE 4
STATE WATER PLAN LOAN PROGRAMS

PROGRAM	TYPE	ELIGIBLE USES	METHOD OF FINANCE
Water Infrastructure Fund (WIF)	Self Supporting/Non-Self Supporting Bonds (the majority of the debt service is funded by loan repayments; currently 2 of the 5 issuances are self supporting)	Planning, design and construction of water supply, wastewater and flood control projects which are strategies in the State Water Plan	Subsidized loans, some with deferrals; utilized since fiscal year 2008 for projects implementing State Water Plan strategies
State Participation Program (SPP)	Self Supporting/Non-Self Supporting Bonds (as the program matures, bond issues become self supporting; currently 5 of the 6 issuances are self supporting)	Regional development of projects including reservoirs and storm water retention basins for water supply, flood protection and groundwater recharge; facilities for the transmission and treatment of water; and treatment works; includes funding of State Water Plan projects	Temporary state ownership via a purchase contract with interest-deferred repurchase payments back to the State
Economically Distressed Areas Program (EDAP)	Non-Self Supporting Bonds	Planning, design and construction of water supply and wastewater projects in (1) areas with a median household income no greater than 75% of the State, (2) an established residential subdivision as of June 1, 2005, and (3) counties with adopted Model Subdivision Rules; includes funding of State Water Plan projects	Grants with at least 10% in loans

Source: Texas Water Development Board.

FIGURE 5
GENERAL REVENUE APPROPRIATIONS FOR STATE WATER PLAN PROJECTS
FISCAL YEARS 2008 TO 2013



Note: Reflects expenditures for fiscal years 2008 to 2012.
Sources: Legislative Budget Board; Water Development Board.

market conditions at the time of issuance including the rate, structure and costs of issuance.

Variables such as interest rates, construction costs, and the timing of project construction make projecting the true cost of the SWP difficult. Using a series of assumptions, however, TWDB developed projections of potential financial demand scenarios for state and local government costs. SWP needs could be addressed through a traditional GO bond funded model. However, this structure has limitations due to the high dollar amount of state bonds that would be needed to meet projected applicant funding requests. An alternative structure would be to establish a revolving loan fund, which may be a more cost effective approach in regards to the level of state funds required.

TRADITIONAL DEBT SERVICE PAYMENT SCENARIO

The average biennial General Revenue Fund requirement to fund debt service payments for SWP-related bond issuances for all 562 projects listed in the SWP from 2014 to 2070 would be $307.2 million. However, as the decade of need for a majority of projects has been reported to be between 2012 and 2021, the average biennial obligation rises to $1.2 billion from 2010 to 2021. For the 2014–15 biennium, $1.8 billion in state funds would be required to meet projected debt service needs, if all projects were funded**. Figure 6** shows the estimated debt service on GO bonds for all SWP programs until 2021. The majority of SWP projects are front-loaded into the planning time line, while less capital-intensive projects begin in later years. This factor contributes to the reduction in average funding required in the 50-year planning horizon.

FIGURE 6
DEBT SERVICE REQUIREMENTS FOR ALL SWP PROJECTS
FISCAL YEARS 2014 TO 2021

(IN MILLIONS) FISCAL YEAR	WATER INFRASTRUCTURE FUND CONSTRUCTION	WATER INFRASTRUCTURE FUND RURAL	WATER INFRASTRUCTURE FUND DEFERRED	STATE PARTICIPATION	ESTIMATED BIENNIAL NEED
2014	$1,061.9	$28.3	$169.9	$99.3	--
2015	166.2	12.5	179.7	108.3	$1,826.1
2016	117.1	12.5	179.7	108.3	--
2017	117.1	12.5	179.7	85.8	812.9
2018	117.1	12.5	179.7	85.8	--
2019	177.1	12.5	179.7	74.6	779.2
2020	459.4	21.6	234.5	95.4	--
2021	170.7	16.5	237.7	81.4	1,317.2
Total	**$2,386.7**	**$129.0**	**$1,541.0**	**$738.9**	**$4,735.4**

Source: Texas Water Development Board.

BONDS AND THE CONSTITUTIONAL DEBT LIMIT

The more self-supporting debt the state can issue (i.e., debt that is covered via a dedicated funding mechanism), the less impact SWP funding would have on the constitutional debt limit (CDL). The Texas Constitution, Article III, Section 49-j, limits the authorization of additional state debt if the percentage of debt service payable from the General Revenue Fund exceeds 5 percent of the average annual unrestricted General Revenue Fund revenues for the previous three fiscal years. As of the end of fiscal year 2011, the Bond Review Board estimated the CDL ratio for issued and authorized but unissued debt, was 3.7 percent, as shown in **Figure 7**.

As a result of Proposition Two approved by voters in 2011, TWDB is able to issue additional GO bonds as long as no more than $6 billion from that additional authority is outstanding at any one time. These water bonds are voter authorized as self-supporting debt. Certain programs such as SPP and WIF, however, are initially issued as non self-supporting and appropriations of General Revenue Funds are required for debt service payments. Once those bond issuances begin receiving loan repayments to pay debt service, they are reclassified as self-supporting. Of total reported needs for state financial assistance in the SWP, nearly $15.7 billion is expected to occur between 2010 and 2020. According to TWDB, the existing constitutional bonding authority is not sufficient to provide $15.7 billion in financing under the traditional/debt service model. Further, any bonds issued under the traditional method that requires General Revenue Funds for debt service are considered non self-supporting and would impact the CDL. There is not enough debt authority capacity under the CDL to allow for the issuance of $15.7 billion in financing. By issuing self-supporting debt or making direct loans without the issuance of bonds, the state would provide a more cost-effective and reliable funding mechanism for TWDB to use when financing approved applications for SWP projects. This mechanism would also limit the state's debt obligations counted towards the CDL.

FIGURE 7
STATUS OF CONSTITUTIONAL DEBT LIMIT
FISCAL YEAR 2011

Constitutional Debt Limit (CDL)	5.0 percent
Fiscal Year 2011 CDL Ratio	3.7 percent
Maximum Debt Service: 5.00% of three year Unrestricted General Revenue Funds	$1,782.3 million
Debt Service, Issued and Unissued (fiscal year 2011)	$1,318.2 million
Debt Service Capacity	$464.1 million
Debt Authority Capacity	$5,323.5 million

Sources: Legislative Budget Board; Bond Review Board.

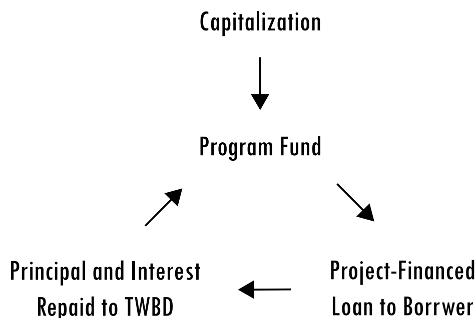
REVOLVING LOAN ACCOUNT STRUCTURES

Historically, when the TWDB has issued bonds, General Revenue Funds alone have been used to pay for debt service on those bonds. This approach adds GO debt that is included in the CDL calculation. In this scenario, all funds appropriated pay for bond debt service payments. No additional funds remain in the program to be used for other

purposes. This approach relies on consistent state funds for the lifetime of the debt service or loan repayment.

A revolving loan account, funded by a single or series of fund capitalizations, is an alternative financing mechanism that can have benefits compared to traditional debt service financing. Revolving loan accounts reduce reliance on state funds and may be able to provide additional project financing during the lifetime of the program. The basic structure of this system is shown in **Figure 8**. Fund capitalization can occur when a fund is created. Loans are funded from money deposited into the fund. The principal and interest of the loan are repaid by the borrower to TWDB. Repayments are deposited back into the revolving fund. This system can retain capital in the program, allowing interest earnings to grow within the fund. Using this structure, the TWDB may eventually be able to apply a portion of interest earnings to pay current or future debt service obligations for SWP projects.

FIGURE 8
REVOLVING LOAN CAPITALIZATION PROCESS, 2012



SOURCE: Texas Water Development Board.

Figure 9 shows the difference in potential state funding obligations between these two financing models. The scenarios include the WIF and WIF deferred loan programs, which have the largest current and projected SWP demand. EDAP would not be revolving because it is primarily a grant fund and repayments received on the small amount that is loaned must be used for debt service. WIF and SPP could both be augmented to include the revolving mechanism; however SPP revolves extremely slowly due to the length and structure of the loans (loans have an extended deferred period and repayments are up to 34 years).

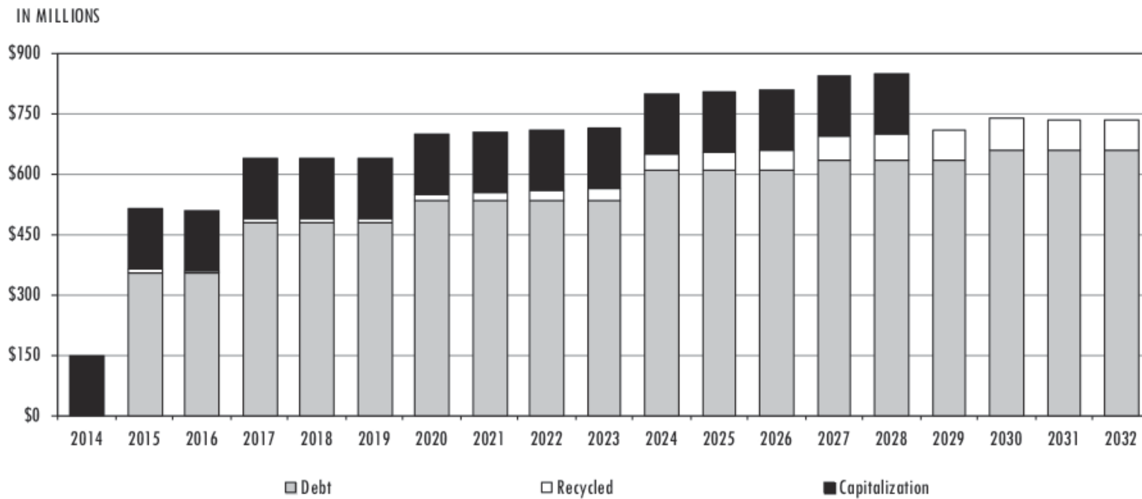
A traditional debt service structure would cost the state $1.8 billion in the 2014–15 biennium. The revolving loan method, illustrated in **Figure 9**, assumes the deposit of $150 million annually for 15 years as an example of a potential capitalization scenario. The model assumes a fixed market interest rate of 5.5 percent and a WIF interest subsidy of 1.5 percent. This subsidy level reflects a historical average based on the 1 percent to 2 percent subsidy offered by TWDB to date. This scenario does not account for General Revenue debt service on existing WIF/SPP debt that currently affects the CDL in the 2014–15 biennium. The capitalization system would provide increasing levels of funding over time, eventually reaching over $700 million annually, as shown in **Figure 10**. This financing structure does not require non-self supporting debt to be issued. There is also no projected adverse impact on the state's CDL. Once the fund is capitalized to a level sufficient to support necessary projects, it would be able to provide ongoing assistance beyond 2060, with subsidies and deferrals available to support the other funding aspects outlined in the SWP that total $231 billion. A revolving loan account would also allow for the potential use of revenue bonds, leaving GO bonds for other water infrastructure projects not able to be funded by the revolving loan account.

FIGURE 9
METHODS OF FINANCING THE STATE WATER PLAN, (BILLIONS) 2010 TO 2060

	TRADITIONAL[1]	CAPITALIZATION[2]
Projects Funded more than 50 years	$26.9	$33.2
Debt to be incurred by state*	$66.5	--
Borrower Repayments	$59.2	--
Overall state cost through 2060	$8.6	$2.3
Cost in 2014–15 Biennium	$1.8	$0.6
Ongoing Project Funding	No	Yes

*Estimated Principal and Interest.
[1]Continued reliance on General Revenue to provide debt service on General Obligation bonds.
[2]Use of self-supporting general obligation or revenue bonds.
SOURCE: Texas Water Development Board.

FIGURE 10
POTENTIAL FUND CAPITALIZATION TIMELINE
FISCAL YEARS 2014 TO 2032



Source: Texas Water Development Board.

EXAMPLES OF OTHER REVOLVING LOAN INFRASTRUCTURE FUNDING MODELS

There are several examples in Texas of the financing of major infrastructure projects with a revolving loan structure, the following two of which relate to water policy and large capital infrastructure projects. These programs were funded with a significant, up-front capitalization and have been successfully accomplishing program goals through a revolving loan structure.

CLEAN WATER STATE REVOLVING LOAN PROGRAM

One revolving loan account currently used for water programs is the federal Clean Water State Revolving Fund (CWSRF), administered by TWDB. The CWSRF revolving loan program was established in 1987 and is a fund used to support a wide variety of water quality projects. These projects include non-point source, estuary management projects, and watershed protection or restoration, as well as other municipal wastewater treatment projects.

States typically must provide a 20 percent match for the federal capitalization grants provided by the Environmental Protection Agency. CWSRF monies are loaned to communities and loan repayments are recycled back into the program to fund additional water quality protection projects. Nationally, the federal government has capitalized the program with more than $25 billion and state matching funds total $5.3 billion since the program was established in 1987. Using fund assets as collateral, 27 states have issued revenue bonds to leverage CWSRF programs and have provided $20.6 billion, nationally, for water quality projects. Federal and state capitalization funds are combined with interest earnings on investments, bond proceeds, and loan repayments to provide low-interest loans.

STATE INFRASTRUCTURE BANK

State Infrastructure Banks (SIB) were authorized by federal law in 1995 as a part of the National Highway System Designation Act (NHS) to help accelerate needed transportation mobility improvements. This was organized through a variety of financial assistance options made to local entities through state transportation departments.

Texas was chosen as one of 10 original states to test the pilot program. The Legislature authorized the Texas Department of Transportation (TxDOT) to administer the SIB program in 1997 as a revolving loan program in the State Highway Fund (Fund 006). Applicants eligible for participation include public or private entities that finance, construct, or maintain eligible transportation projects. SIB projects must relate to federally aided highway systems.

Ninety loans have been approved by the Texas Transportation Commission, TxDOT's governing body. These loans total more than $382 million from the SIB program. The loans have helped leverage more than $3.5 billion in transportation projects in Texas. Financial assistance may be granted in the

form of loans as well as a variety of credit enhancements such as lines of credit, letters of credit, bond insurance, and capital reserves. Loans may be funded from available SIB resources or through the sale of revenue bonds by the Texas Transportation Commission.

Recommendation 1 would amend the Texas Water Code, Chapter 15, to establish an Other Fund for the deposit of monies to be used in financing SWP projects. The fund would be within the Texas State Treasury and monies deposited into the fund would not be used for budget certification purposes. Appropriations made out of the fund would be used to support TWDB programs that may finance SWP-related projects, including WIF, SPP, and EDAP. The TWDB would be authorized to use appropriations made out of the fund to capitalize and operate a revolving loan account. The revolving loan structure for these programs would operate in a similar fashion to the CWSRF and the SIB. Doing so would maximize the ability of the state to support SWP projects. According to TWDB calculations, a revolving fund structure would use state funding more efficiently than traditional SWP financing methods. This is also the same structure TWDB has used to administer the CWSRF for 25 years. This structure can be augmented by the issuance of bonds. It should be noted that the capitalization of a revolving loan fund, though potentially the most economically feasible route for the state to pursue, may not result in sufficient assistance being made available to local applicants seeking financing in the coming decade, although it would in the long-term.

FUND THE STATE WATER PLAN

Providing financial assistance from the state would help local entities ensure their water infrastructure will be sufficient to meet projected demand in the foreseeable future. The state can contribute to ensuring that economic growth in the state will not be inhibited by water supply constraints. By providing loans with highly competitive terms, local entities will also be able to make the necessary improvements to their infrastructure and avoid taking on more debt than is necessary. As current state financial assistance for water-related projects is insufficient to meet the needs identified in the SWP, additional sources of revenue should be applied to addressing these needs. Recommendation 2 would fund the SWP to maintain sufficient water supplies in the state through a self-sustaining, dedicated source of revenue. The following four options represent approaches the Texas Legislature could choose to fund the SWP. These options include redirecting existing state funds, creating new revenue sources, increasing an existing fee, or repealing current tax exemptions that are related to state water policy. The Legislature could also choose to provide a one-time capitalization of the fund established through Recommendation 1 in order to increase the loan capacity of the fund more quickly. This one-time capitalization could be implemented in addition to the options presented below.

OPTION 1: USING EXISTING FUNDS

The miscellaneous gross receipts tax (MGRT) is imposed on each water, gas, and electric utility company located in an incorporated city or town having a population more than 1,000. The tax applies to utility companies that sell and distribute water, gas, or electricity within an incorporated city or town. The tax does not apply to utilities operated by municipalities or electric cooperatives, unless they elect to enter the competitive market.

This tax has been in effect since 1907 and not modified significantly since the Fifty-sixth Legislature did so in 1959. The tax is computed by applying the prescribed tax rate to the utility company's gross receipts from business in an incorporated city or town, as shown in **Figure 11**.

FIGURE 11
MISCELLANEOUS GROSS RECEIPTS TAX CALCULATION

CITY POPULATION	TAX RATE
More than 1,000 but less than 2,500	0.581 percent
2,500 or more but less than 10,000	1.07 percent
10,000 or more	1.997 percent

SOURCE: Comptroller of Public Accounts.

The MGRT comprises roughly 84 percent of state utility tax revenues. Tax collections in the last several years have been approximately $400 million annually. Of monies received, one-fourth of the revenue is allocated to the Foundation School Fund and three-fourths to the General Revenue Fund. The Comptroller's projection of future tax collections is for revenue to increase, due to rising population and employment, as well as increasing national and state economic growth. Recommendation 2, Option 1 would amend the Texas Tax Code, Chapter 182, to allocate one-half of revenue generated from the miscellaneous gross receipts tax that would have otherwise been deposited to the General Revenue Fund to the Other Fund developed in Recommendation 1. Given that the tax is collected from utilities, including water suppliers, there would be a correlation with funding water infrastructure projects

through this revenue source. Water utilities that pay the tax could also potentially be beneficiaries of state financial assistance for SWP projects.

OPTION 2: CREATE A STATEWIDE WATER USAGE FEE

According to academic research, much of the state's water resource base is undervalued. This is because processed water rates charged by water suppliers such as utilities, districts, and authorities primarily reflect infrastructure supply costs, and not the intrinsic value of water as a finite resource. In general, water rates are typically based on non-water costs such as the energy, labor, pipe, machinery, transportation, and filtration used to clean and transport the water. Water rates are not typically calculated to include the value of the water, itself. If this were done for other commodities such as oil, for example, gasoline would be priced as if in-the-ground oil cost nothing and only the cost of drilling, refining, and transportation were reflected in the price. Given this undervaluation, water demand can exceed water supply in various regions of the state. This behavior can subsequently lead to water being over pumped, which can impact overall water availability in Texas.

Water rates set by the many public water providers across the state vary greatly. Reflecting only supply and delivery costs, individual markets do not adequately acknowledge a statewide valuation of water. This contributes to a greater demand for water, which creates pressure to expand infrastructure. The increase in demand for water has prompted local governments in the U.S. to consider implementing demand management responses to decrease water consumption.

One such method is conservation pricing of water, which is directly tied to the volume of withdrawals made by an individual entity. This pricing often includes an inclining block-rate structure or seasonal adjustments in the rate of the charge. An inclining block-rate structure is the most common conservation rate structure used by water providers. This residential-rate design includes an initial tier, which contains the baseline charge. Subsequent tiers are priced significantly higher. In Florida, for example, 14 of the 16 main utilities have implemented a water conservation fee with an embedded inclining block-rate structure. A water usage fee, coupled with an inclining block-rate structure, can delay the need for system expansion and acquiring additional water supplies and storage capabilities by decreasing demand for water.

Recommendation 2, Option 2 would amend the Texas Water Code, Chapter 13, to implement a two-tiered statewide water usage fee. The fee would apply a rate of $.03 per 1,000 gallons of water sold by utilities to retail utility customers, including residential, commercial, irrigation, and industrial customers. In addition to this fee, a separate tier would exist within the residential sector to apply a surcharge of $1 per 1,000 gallons of water sold to residential users, should their individual usage be greater than 12,000 gallons per month, approximately twice the average residential user's consumption. The fee would be collected by public water supply systems, and remitted to the Comptroller of Public Accounts and deposited into the Other Fund created by Recommendation 1 to finance SWP projects. To reflect the relative incidence of the fee on various sectors of the state, a breakdown of the volume of water sold by utilities is shown in **Figure 12**.

The relative incidence of the fee is primarily attributed to residential consumption. The estimated impact of this fee on the average monthly residential utility bill would be an increase of approximately $0.23 per month. Based on a survey performed by the Texas Municipal League in 2012 for municipal water bills, this would equate to a 0.8 percent increase in the average residential water bill. The estimated effect on the average commercial business would be an increase of approximately $1 per month. As increases in population is the main constraint on future water supplies, this fee would provide a revenue source representative of the regional needs for the various projects outlined in the SWP.

The usage fee is not tied to a certain utility's taxable value of water or how many consumers a utility provides service to, but is directly tied to an individual entity's consumption of water. This in turn would help stimulate increased awareness and, therefore, increased water conservation in the state. Significant increases in water conservation, above what is projected in the SWP, will yield long-term savings via reduced water usage and the avoided cost of infrastructure projects.

OPTION 3: INCREASE THE PUBLIC HEALTH SERVICE FEE

The Texas Commission on Environmental Quality (TCEQ) is authorized by the Texas Health and Safety Code, Chapter 341, to apply fees to public drinking water systems. Charges must generate sufficient revenue to cover the cost of administering programs in Chapter 341 or the federal Safe Drinking Water Act. Additionally, TCEQ may also use fee revenue to "cover any other costs incurred to protect water resources in the state." Thirty-three separate fees are collected for this purpose, and the Public Health Service fee (PHS) collects the second highest revenue, behind the Consolidated

FIGURE 12
UTILITY SALES VOLUME IN ACRE-FEET
FISCAL YEAR 2010

WATER ESTIMATES FOR COMMUNITY PUBLIC WATER SUPPLIERS	CONNECTIONS	ACRE-FEET PER YEAR	PERCENTAGE OF TOTAL VOLUME
Residential	7,705,184	2,212,034	61.24
Commercial	456,966	615,388	17.04
Irrigation	53,208	121,888	3.37
Industrial (public supplied)	23,135	690,890	19.13
Industrial (self-supplied)	N/A	774,772	21.45
Government and fire service	200,542	164,036	4.54
Other	38,069	101,810	2.82
Total	**8,477,104**	**3,611,910**	**100.00**

Sources: Legislative Budget Board; Texas Water Development Board; Texas Commission on Environmental Quality; American Water Works Association.

Water Quality Fee. Revenue from PHS fee collections is deposited into the Water Resources Management Account (General Revenue–Dedicated Funds). TCEQ adjusted fee levels for the PHS, the Consolidated Water Quality Fee, and the Water Use Assessment Fee in 2009 in order to support agency appropriations and prevent a shortfall in the Water Resources Management Account. The Water Resources Management Account is the primary source of state funding for water program-related activities at TCEQ.

The purpose of the PHS fee is to support the testing and certification of drinking water supplies as well as to protect the water resources of the state. The fee applies to approximately 7,928 payers who are public water providers. This includes a public water system of any type and encompasses approximately 9 million total water service connections. The rate of the fee is shown in **Figure 13**, and reflects current rates set forth in Chapter 290, Subsection E of the Texas Administrative Code. As most municipalities in the state have greater than 160 connections, 98 percent of revenue collected would be categorized as Tier 3. The current fee level of $2.15 per connection is the equivalent of a charge of $0.18 cents per month, per household.

The current assessment rate of $2.15 per connection generated approximately $20.1 million in fiscal year 2012. If the fee were raised, additional revenue, above amounts currently appropriated to TCEQ for water-related activities, could be allocated to TWDB to support state financing of water infrastructure needs. Raising the fee for these purposes would be consistent with current statutory authority to assess the fee to cover any costs incurred to protect water resources in the state.

FIGURE 13
PUBLIC HEALTH SERVICE ANNUAL FEE STRUCTURE, FISCAL YEAR 2012

TIER	MINIMUM NUMBER OF CONNECTIONS	AMOUNT DUE	NUMBER OF CONNECTIONS, FISCAL YEAR 2011
1	Less than 25	$100	44,382
2	25 to 160	$175	133,696
3	Greater than 160	Up to $2.15 for each connection	9,018,987

Note: Differences may exist for non-community and federal or state institutions.
Source: Texas Commission on Environmental Quality.

Revenue from the PHS fee effects all public water system connections in the state, and is therefore an equitable method of financing public infrastructure projects. The PHS fee encompasses more public water system suppliers than any other fee collected and remitted to the Water Resources Management Account. Recommendation 2, Option 3 would amend the Texas Water Code to codify the Public Health Service Fee and adjust the level of the third tier fee to $15, annually, per connection. Revenue above appropriations to TCEQ for water resource management activities would be dedicated to funding SWP projects. Allocation of the current assessment would be preserved to avoid negatively impacting current state water management programs. Revenue generated by the fee would be greater in regions of the state that contain larger populations or general economic activity. The most highly populated areas of the state are also the regions requesting the greatest amount of state assistance for water projects. Therefore, there would be a correlation with regional revenue collections and financial assistance received

from the state. For every dollar increase in the PHS fee, an additional $9.2 million in total revenue would be generated.

OPTION 4: ELIMINATE THE SALES TAX EXEMPTION FOR BOTTLED WATER

Since the inception of the state sales tax in 1961, water has been exempt from the sales and use tax in Texas. Nationally, bottled water without flavoring, sweetener, or carbonation is often exempt from taxation. Many states consider bottled water to be classified as a food, the rationale for this, in part, being that bottled water can be purchased with food stamps. According to survey data from TWDB and the Federation of Tax Administrators, thirty-one states, including Texas, currently exempt food and/or most groceries from sales tax. Twenty-one states levy some form of taxation on bottled water. Fourteen states tax bottled water as it is considered a food product that is taxed at the general or reduced state rate. Several other states levy sales taxes on bottled water despite a general food exemption. **Figure 14** shows states with taxable food and bottled water sales.

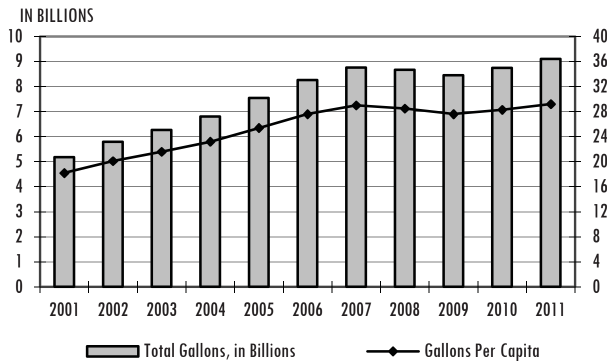
At the time, the water exemption was included in the original Texas sales tax, bottled water consumption was minimal compared to current levels of consumption. In 1976, less than 500,000 gallons of bottled water were sold in the U.S.. Data from the Beverage Marketing Corporation shows, however, that consumption has increased to over 8 billion gallons of bottled water sold annually nationwide, 16,000 times the volume sold 30 years prior. The progressive increase of bottled water consumption during the previous decade is shown in **Figure 15**. Although studies have shown that bottled water is often no healthier than tap water, it can cost up to 10,000 times more. Texas accounts for an increasing market share of bottled water consumption, accounting for

FIGURE 14
STATES WITH TAXABLE FOOD AND BOTTLED WATER SALES, 2012

STATE	STATE GENERAL TAX RATE (PERCENT)	FOOD (PERCENT)	BOTTLED WATER
Alabama	4	Taxable	Taxable
Arkansas	6	1.5	Taxable
Colorado	2.9	Exempt	Exempt; however, bottled water served to customers or employees is taxable.
Hawaii	4	Taxable	Taxable
Idaho	6	Taxable	Taxable
Illinois	6.25	1	Taxable
Kansas	6.3	Taxable	Taxable
Louisiana	4	Exempt	Taxable
Maryland	6	Exempt	Taxable
Michigan	6	Exempt	Taxable
Minnesota	6.875	Exempt	Taxable when the container size is less than 1/2 gallon; exempt when sold in individual containers of one-half gallon or more in size.
Mississippi	7	Taxable	Taxable
Missouri	4.225	1.225	Taxable
New York	4	Exempt	Taxable
Oklahoma	4.5	Taxable	Taxable
South Dakota	4	Taxable	Taxable
Tennessee	7	5.5	Taxable
Utah	5.95	1.75	Taxable
Virginia	5	2.5	Taxable
West Virginia	6	2.0	Taxable
Wyoming	4	Exempt	Taxable

Sources: Texas Water Development Board; Federation of Tax Administrators.

FIGURE 15
U.S. BOTTLED WATER MARKET, VOLUME AND GROWTH
FISCAL YEARS 2001 TO 2011



SOURCE: Beverage Marketing Corporation.

approximately 13 percent of total consumption of bottled water in 2009, ranking second behind California.

Industry sources estimate that approximately 31 percent of water bottles are recycled. Most plastic bottles that are not recycled end up in landfills, accounting for between 0.5 percent and 1.0 percent of solid waste disposed of annually. According to a 2009 Government Accountability Office study, the bottles in landfills do not pose a significant short-term risk. The study indicates, however, that plastic bottles decompose over a very long time horizon, as much as thousands of years. For waste management purposes, experts assume that the plastic bottles will never decompose.

Recommendation 2, Option 4 would amend the Texas Tax Code, Section 151.315, to eliminate the sales tax exemption for water sold in sealed containers. This change applies the state sales tax to retail sales of bottled water. This would not include non-packaged bulk water delivered by tanker truck and dispensed into residential cisterns or wells, nor would it include water sold at community dispensers. An estimated 40 percent of bottled water may come from municipal sources, suggesting that many of the companies involved in this industry would be dependent on public water systems. Additionally, bottled water consumption is typically discretionary, as consumers could purchase other tax-exempt products or drink tap water instead.

IMPACT OF RECOMMENDATIONS ON STATE WATER PLAN FINANCING

Financing the SWP using a traditional GO bond financing structure based on the projected requested need for financing listed in the SWP, would require $1.8 billion in state funding for debt service payments for the 2014–15 biennium. Based on project results from the implementation of a revolving loan structure and an infusion of approximately $150 annually for 15 years, either Option 1, Option 2 or Option 3 could individually meet long-term capitalization goals of providing at least $26.9 billion in state financing assistance. Option 4 does not generate sufficient revenue for as timely of a capitalization of the account, but could be used in conjunction with other options to achieve this goal.

The total amount of state assistance being requested by regional planning entities to fund all other non-supply related strategies, totaling approximately $178 billion as described in the 2012 SWP, is unknown at this time. The state could conceivably be asked in the future to supply additional financial assistance for the remaining elements in the SWP.

Recommendation 3 would include a contingency rider in the 2014–15 General Appropriations Bill to appropriate revenue estimated to be collected from the option selected in Recommendation 2 to the Texas Water Development Board to fund State Water Plan projects.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendation 1 would create a dedicated Other Fund for the deposit of monies to be used by the state in financing SWP projects. No fiscal impact to the state is anticipated as a result of this recommendation.

Recommendation 2, Option 1 would amend statute to allocate one-half of revenue generated from the miscellaneous gross receipts tax that would have otherwise been deposited to the General Revenue Fund, to the Other Fund established by Recommendation 1. This would result in a loss of $301.4 million in General Revenue Funds and a gain of a like amount in Other Funds during the 2014–15 biennium. The five-year fiscal impact of Option 1 is shown in **Figure 16**.

FIGURE 16
FIVE-YEAR FISCAL IMPACT OF RECOMMENDATION 2, OPTION 1
FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE REVENUE GAIN/(LOSS) TO GENERAL REVENUE FUND	PROBABLE REVENUE GAIN/(LOSS) TO OTHER FUNDS
2014	($149,958,305)	$149,958,305
2015	($151,457,889)	$151,457,889
2016	($152,972,467)	$152,972,467
2017	($154,502,192)	$154,502,192
2018	($156,047,214)	$156,047,214

SOURCE: Legislative Budget Board.

Recommendation 2, Option 2 would implement a statewide water usage fee, set at $0.03 per 1,000 gallons consumed. Revenue would be deposited to the Other Fund established by Recommendation 1. Option 2 would incorporate an additional fee of $1 per 1,000 gallons for residential users that consume over 12,000 gallons per month. The five-year fiscal impact of this recommendation is shown in **Figure 17**. This would result in a revenue gain of $304 million in Other Funds in the 2014–15 biennium.

FIGURE 17
FIVE-YEAR FISCAL IMPACT OF RECOMMENDATION 2, OPTION 2
FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE REVENUE GAIN/(LOSS) TO OTHER FUNDS
2014	$151,952,381
2015	$152,104,333
2016	$152,256,438
2017	$152,408,694
2018	$152,561,103

SOURCES: Legislative Budget Board; Texas Water Development Board.

The methodology for these calculations is based on analysis by the TWDB and LBB of data from American Water Works Association, data from the TCEQ and data from the TWDB Water Use Survey. The proposed fee allows local utilities to retain 0.5 percent of revenues derived from the fee to offset administrative costs.

Recommendation 2, Option 3 would amend statute to codify the Public Health Service Fee. Revenue would be dedicated to funding SWP projects above appropriations made for Water Resources Management at TCEQ. This would result in a revenue gain of $232.9 million in Other Funds for the 2014–15 biennium. The five-year fiscal impact of this recommendation is shown in **Figure 18**.

FIGURE 18
FIVE-YEAR FISCAL IMPACT OF RECOMMENDATION 2, OPTION 3
FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE REVENUE GAIN/(LOSS) TO GENERAL REVENUE–DEDICATED ACCOUNT 0153	PROBABLE REVENUE GAIN/(LOSS) TO OTHER FUNDS
2014	$0	$115,893,983
2015	$0	$117,052,923
2016	$0	$118,223,452
2017	$0	$119,405,687
2018	$0	$120,599,743

SOURCES: Legislative Budget Board; Texas Commission on Environmental Quality.

Recommendation 2, Option 4 would repeal the sales tax exemption for bottled water and deposit revenue collected from the tax to the Other Fund established by Recommendation 1. This would result in a revenue gain of $147 million in Other Funds for the 2014–15 biennium. It is estimated that local governments would collect an additional $42 million during the same period. The five-year fiscal impact of this recommendation is shown in **Figure 19**.

FIGURE 19
FIVE-YEAR FISCAL IMPACT OF RECOMMENDATION 2, OPTION 4
FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE REVENUE GAIN/(LOSS) TO OTHER FUNDS	PROBABLE REVENUE GAIN/(LOSS) TO LOCAL GOVERNMENT
2014	$73,000,000	$21,000,000
2015	$73,730,000	$21,210,000
2016	$74,467,300	$21,422,100
2017	$75,211,973	$21,636,321
2018	$75,964,093	$22,852,684

SOURCES: Legislative Budget Board; Texas Water Development Board.

Depending on the funding option selected and the amount of annual financial assistance that option may be able to provide, the TWDB reports that there would also be an increase in agency administrative costs. For example, if the funding option was estimated to provide $500 million in

annual financing assistance, the TWDB would request 8 additional full-time-equivalent employees for a total additional cost of $1.4 million in the 2014–15 biennium. Recommendation 3 would include a contingency rider in the 2014–15 General Appropriations Bill to appropriate revenue estimated to be collected from the option selected in Recommendation 2 to TWDB to fund SWP projects.

Recommendations to adequately fund and enable greater state-assisted financing of SWP projects would have a positive impact to local units of government. Local governments could receive reduced interest loans through the Texas Water Development Board. This would thereby reduce the level of total debt local entities would normally incur by utilizing more standard loan arrangements. The fiscal savings are particular to SWP projects and available financing terms at the time of loan processing. The overall fiscal savings to units of local government cannot be determined.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

ENHANCE STATE PARTICIPATION IN MUNICIPAL WATER CONSERVATION

Between 2010 and 2060, the Texas Water Development Board projects total statewide water demand to increase by 22 percent, while water supplies are projected to decrease 10 percent. This projection leaves an estimated additional need of 8.3 million acre-feet of water to meet future demands. Municipal water systems and power generators are projected to account for the greatest percent increases in demand during this time.

Water conservation is the most cost efficient method to enhance current water supplies compared to other water management strategies. Increasing the level of water conservation achieved by municipal water suppliers would reduce the cost of meeting State Water Plan supply goals. Increased water conservation by the public would improve the sustainability of this resource and reduce increases in household utility expenditures. Nationwide, municipal water rates have increased 18 percent from 2010 to 2012.

The state's involvement with the regulation and funding of water conservation initiatives varies; most of the responsibility resides with local governments. Local governments have significant latitude in their water management decision-making, which gives them greater flexibility in how they manage this resource. This flexibility can, however, lead to regional disparities in the use and value of water. The state can have greater influence encouraging a more effective water conservation and management policy by providing resources to increase public awareness through education, collecting and analyzing relevant data, and more effectively aligning the efforts of local governments.

FACTS AND FINDINGS

- ♦ The estimated cost of implementing State Water Plan supply management strategies so Texas has sufficient quantities of water in the future is $53.1 billion.
- ♦ Total water lost from pipe distribution leaks in Texas is estimated at 16.7 percent of all water distributed, representing a total value of approximately $655.9 million annually to local utilities.
- ♦ Factoring average capital costs of municipal water strategies in the State Water Plan, a reduction in water consumption of one gallon per capita per day by all Texans could potentially avoid $407.2 million of capital costs, or 0.77 percent of the $53.1 billion total.

CONCERNS

- ♦ Funding for the state's public awareness water conservation program, Water IQ, is not sufficient to provide the level of outreach needed to maximize its potential. Expanded efforts would further the awareness of water as a finite resource and increase public water conservation.
- ♦ The Water Conservation Advisory Council reports on the monitoring and implementation of water conservation strategies in the state. The council does not provide the Texas Legislature with conservation-specific recommendations.
- ♦ The state mandates the completion of several water planning reports. These reports have overlapping requirements related to both conservation and general water management and planning. However, none of these reports gauge the effectiveness of implemented conservation measures. There is a lack of resources, tools, and proper methodology to track the levels of overall water strategy implementation. As such, there is no precise quantitative measure to determine whether strategies are producing the savings predicted.
- ♦ Most utilities are only required to submit water loss audit reports to the state every five years. This infrequent reporting reduces the ability of local entities as well as the state to track water consumption accurately.
- ♦ Utility systems that have significant rates of water loss are permitted to apply for additional state assistance to increase water supplies without having to reduce water loss rates.
- ♦ Fewer than 25 percent of water suppliers reported instituting any formal drought restrictions in 2011, which was the most intense single year drought on record. Of suppliers that did enact restrictions, a significant portion did so only after being in a stage

of exceptional drought, the highest drought intensity category, for more than several months.

- ♦ Additional research and development could better inform local level decision-making about water management and conservation. New technologies and increased knowledge about the applicability of existing technologies could increase the effectiveness of water management in the state. This includes improvements in the process of recycling and reusing water.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Increase appropriations to the Texas Water Development Board by $6 million of General Revenue Funds in Strategy A.3.1, Water Conservation Education & Assistance, in the 2014–15 General Appropriations Bill for the Water IQ program.
- ♦ **Recommendation 2:** Amend statute to require the Texas Water Conservation Advisory Council to include recommendations for the improvement of water conservation in the state in their biennial report to the Legislature.
- ♦ **Recommendation 3:** Increase appropriations to the Texas Water Development Board by $0.7 million of General Revenue Funds in Strategy A.2.2, Water Resources Planning, in the 2014–15 General Appropriations Bill and include a rider to direct the use of these funds for improvements in data collection and management relating to utility conservation implementation.
- ♦ **Recommendation 4:** Amend statute to require utilities to audit the water lost in their systems on an annual basis, rather than every five years.
- ♦ **Recommendation 5:** Amend statute to authorize the Texas Water Development Board to require state financing recipients to address their system water loss. The agency may, by rule, establish appropriate thresholds and processes for determining application of the requirement.
- ♦ **Recommendation 6:** Amend statute to require local entities to implement their drought contingency plan upon the issuance of an Emergency Disaster Proclamation by the Governor for exceptional drought conditions.
- ♦ **Recommendation 7:** Amend statute to require the Texas Water Development Board to consider the timely implementation of drought contingency plans by entities applying for financial assistance.
- ♦ **Recommendation 8:** Increase appropriations to the Texas Water Development Board by $3.7 million of General Revenue Funds in Strategy A.2.2, Water Resources Planning, in the 2014–15 General Appropriations Bill and include a rider to direct the use of these funds for grants related to the reuse and recycling of water, as well as other efforts that would benefit the state's knowledge and management of water through the Innovative Water Technologies program.

DISCUSSION

In the next 50 years, the Texas Water Development Board (TWDB) expects total statewide water demand to increase by 22 percent. This demand is projected to exceed currently available supplies. Available water supplies are projected to decrease 10 percent during the same period, which leaves a projected additional need of 8.3 million acre-feet of water to meet future demands. The State Water Plan (SWP) includes 562 projects with an estimated 50-year cost of $53.1 billion to increase the supply of water. Compared to other strategies outlined in the SWP, water conservation is the most cost efficient method to enhance the state's water supplies.

Municipal water systems and power generators are projected to have the largest percent increases in demand for water. Municipal water conservation strategies focus on reducing water use in the residential, commercial, and institutional sectors. These strategies can focus on consumer behavior, such as changing water pricing structures; developing a greater awareness of conservation through promotional and educational campaigns; or by technological approaches, such as installing more efficient plumbing fixtures in homes and businesses; and providing financial rebates or incentives for the installation of such fixtures.

Conservation focuses on efficiency of use and the reduction of demands on existing water supplies. In 2010, approximately 767,000 acre-feet per year from water conservation savings projects is recommended in the SWP. This amount gradually rises to nearly 2.2 million acre-feet per year by 2060 from all conservation strategies. Municipal conservation accounts for 650,000 acre-feet of the 2.2 million acre-feet made available through all forms of water conservation, or 7.2 percent of the total volume of water made available through SWP strategies.

An acre-foot is the amount of water needed to cover an acre of land to a depth of one foot, or 325,851 gallons. One acre-foot equates to the average annual usage of two families. Total projected capital costs for all SWP conservation and reuse strategies is $6.2 billion, or 11.7 percent of the $53.1 billion total for supply management. This also represents 34.4 percent of all water made available through SWP strategies. Of this amount, $24.2 million is specifically for municipal conservation.

Conservation programs can postpone or eliminate the need for new infrastructure. The projected population of the state will be approximately 46.3 million by 2060. The amount of water used by an individual is measured as their gallons per capita per day (GPCD) of water consumed. Factoring average capital costs of municipal water strategies in the SWP, a reduction in water consumption of one GPCD by all Texans could potentially avoid $407.2 million of capital costs, or 0.77 percent of the $53.1 billion total.

Additional conservation would yield additional savings to state and local governments. Actual savings would depend where the savings occur and which specific projects are delayed or foregone. If all recommended conservation and reuse strategies in the SWP were implemented, the average municipal GPCD would decline from its estimated 2010 value of 154 to 138.4 GPCD by 2060. Municipal GPCD in the SWP includes both commercial and institutional water use in addition to residential use. The average annual costs (dollar per acre-foot) of municipal water conservation and other water management strategies are shown in **Figure 1**.

According to research published in 2008 by the Alliance for Water Efficiency, a non-profit advocacy group, water conservation can offer positive economic benefits. For every $1 million invested in indoor, outdoor, and water system efficiencies, the following outputs, per the Alliance for Water Efficiency, can be expected:

- economic output of $2.5 to $2.8 million;
- gross domestic product benefits between $1.3 to $1.5 million; and
- 15 to 22 jobs created or sustained.

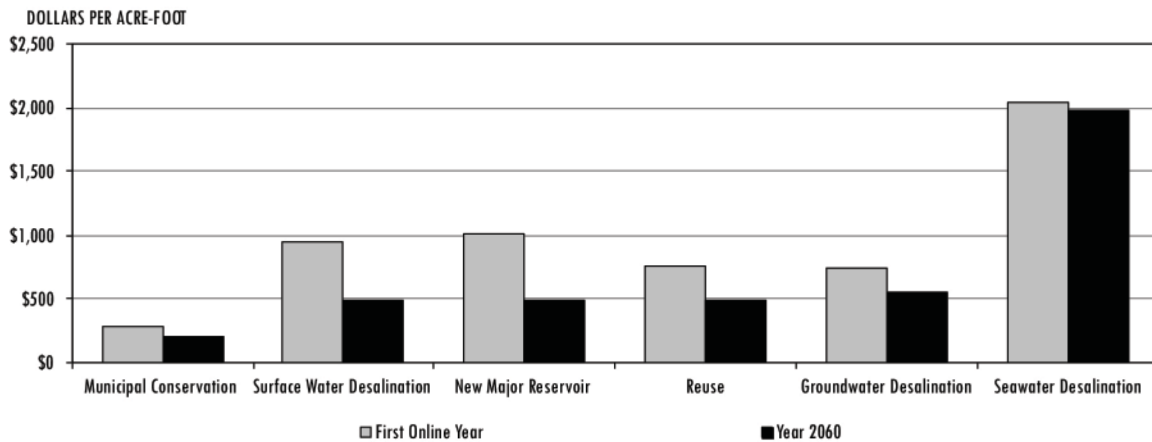
The results are achieved through increases in system water loss control, utility rebate programs as well as survey, retrofit and installation programs for the residential, commercial and industrial sectors.

LOCAL WATER CONSERVATION

Areas that have been most active in water conservation are those where demand exceeds available supply, or where development of additional water sources is more expensive than implementation of conservation strategies. Areas of the state with multiple sources of water, including productive groundwater supplies that are extremely reliable even during dry periods, have been slower to embrace water conservation.

Several Texas cities and water districts provide examples of successful water conservation efforts. A study commissioned in 2006 by the City of Austin compared the success of four Texas water utility programs, measured in per capita daily savings. Per capita savings amounted to 38 percent in El

FIGURE 1
ANNUAL AVERAGE COST OF WATER MANAGEMENT STRATEGIES (DOLLARS PER ACRE-FOOT), FISCAL YEAR 2012



Source: Texas Water Development Board.

Paso, 33 percent in San Antonio, and 7 percent in Austin, based on five-year averages.

San Antonio developed its conservation program partly in response to a decrease in groundwater supply. In the 1990s, the city implemented aggressive conservation strategies as a result of a lawsuit. The lawsuit was regarding an endangered species residing in the Edwards Aquifer that was deemed to be threatened due to groundwater depletion. Since that time, water conservation strategies allowed the San Antonio Water System (SAWS) to reduce its per capita water consumption by 40 percent since 1980. Additionally, 75,000 acre-feet of water is recycled in the public water system annually and up to 93,000 acre-feet is stored underground in an aquifer storage and recovery system. As San Antonio has had to address drought-related issues and is located in a relatively arid region of the state, the city paid greater attention to integrating what some might consider drought management strategies into an ongoing conservation strategy.

In 2003, SAWS commissioned BBC Research and Consulting, a private research firm, to conduct a cost/benefit analysis to show the value of water conservation. The study examined the total capital costs and ongoing operation and maintenance of new water supplies, from 2010 to 2060. The study produced a range of 4:1 to 7:1 in long-term cost savings of water conservation measures versus other capital infrastructure investments. The study also described that savings from conservation programs would negate the need for SAWS to build an additional wastewater treatment plant.

CONSERVATION AWARENESS PROGRAMS

Public information is an essential component of a successful water conservation program. Conservation awareness can be done through water bill inserts, feature articles and announcements in the news media, workshops, booklets, and the distribution of water-saving devices. Awareness programs presented in public schools is also an important means for instilling water conservation awareness. According to the Environmental Protection Agency and other entities, increasing public awareness of conservation, in conjunction with water conservation pricing, can decrease the per capita consumption of water.

Water IQ: Know Your Water, is a Texas public awareness water conservation program. TWDB developed and implemented the program to inform Texans about their water resources. Program information is available online and can support local entities with their public awareness programs. A public awareness guide is available for utilities that would like to develop or expand a conservation program. The Water IQ website, www.wateriq.org, provides local and regional information about water conservation in the state.

Due to the funding Water IQ receives, the program has limited use beyond supporting existing local conservation programs. The program has historically been budgeted approximately $100,000 per biennium. Water IQ relies heavily on its website and any locally funded efforts because it does not have the funding to support significant media outreach.

The North Texas Municipal Water District (NTMWD) used the Water IQ program in conjunction with stage three of its drought contingency plan in June 2006 to reduce consumption during peak summer months. This action was in response to drought conditions and a declining water supply. NTMWD conducted a research study in 2010 which showed a direct correlation between public awareness and conservation behavior. This was exemplified by a ten percent greater likelihood of residents to conserve water that could recall being exposed to specific water conservation advertising. For six consecutive years, the Water IQ and community watering guidelines have helped curb projected peak-day use in the summertime for NTMWD by 200 million gallons per day or 8.8 billion gallons per year.

Public information campaigns related to water management may increase awareness of the value of this resource and subsequently decrease unnecessary consumption. Recommendation 1 would increase appropriations to the Texas Water Development Board by $6 million of General Revenue Funds in Strategy A.3.1, Water Conservation Education & Assistance, in the 2014–15 General Appropriations Bill for the Water IQ program. In TWDB's 2010–11 Legislative Appropriations Request, the agency identified $3 million per fiscal year as adequate funding for this program. Current funding provides for limited staff resources to maintain a web page for Water IQ, support licensing of Water IQ, and promote Water IQ at conferences and events. According to TWDB, the additional funding would support the development of a statewide advertising campaign. Additionally, funding would be allocated for stakeholder research, informational materials, promotional literature, and public events. Increased funding for a statewide education program would provide for universal messaging about the importance of water conservation and best practices on how to maximize efficient water use. This recommendation is consistent with that of nine regional

planning groups in the SWP to fund and implement statewide conservation awareness.

THE WATER CONSERVATION ADVISORY COUNCIL

The Eightieth Legislature, Regular Session, 2007, passed legislation that established the Water Conservation Advisory Council (WCAC). The council's purpose is to provide state agencies, legislative bodies, and the public with expertise in water conservation. The council is required to submit a biennial report on progress made in water conservation in Texas. WCAC monitors and reports on trends in the implementation of conservation initiatives passed by the Texas Legislature and on specific charges assigned by prior legislatures. WCAC was also charged with developing a sector-based methodology for calculating GPCD, per Senate Bill 181, Eighty-second Legislature, Regular Session, 2011.

WCAC is comprised of 23 members, appointed by TWDB. The makeup of the council is diverse, including representation from state agencies, municipalities and various other economic sectors and interest groups. WCAC predominately monitors the goals, trends, technologies, and effectiveness of current water conservation programs. WCAC also 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 for increasing water conservation in various sectors of the state; including municipal, irrigation, industrial and the commercial and institutional sectors. The guide is periodically updated and available to the public and local utility providers on the Save Texas Water website. Representatives from both the Texas Commission on Environmental Quality (TCEQ) and TWDB are council members. The BMPs adopted by WCAC are used as guidance and promoted by the agencies as a resource for the development of local conservation plans.

The current duties of WCAC do not take full advantage of the great variety of experience and expertise contained by its members. Statute does not provide WCAC with the explicit responsibility of including in their biennial report recommendations for statutory, budgetary, or other policy changes the council may deem beneficial to improve Texas water management and conservation in the state. Recommendation 2 would amend the Texas Water Code, Chapter 10, to require WCAC to make recommendations to the Texas Legislature on how to improve conservation and water management. These recommendations should be included in WCAC's biennial report on progress made in water conservation in the state.

A precursor to the WCAC was the Water Conservation Implementation Task Force. The task force was established by legislation passed by the Seventy-eighth Legislature, 2003. Among recommendations made by the task force was the statewide goal of a 1 percent reduction in water consumption by local entities until they reached 140 GPCD. Since then, several regional planning groups have adopted the 140 GPCD target as their regional goal. The council could revisit the 140 statewide GPCD target first identified by the task force in 2004. The task force catalogued prolonged deliberations in reaching this figure; citing initial goals such as 125 GPCD or using other methods such as a summer to winter ratio of water usage to gauge performance. Topics such as this warrant additional research by WCAC, should the state consider pursuing a specific statewide conservation goal in the future.

WATER CONSERVATION PLANS AND REPORTS

Water conservation plans and related reports that are required by TWDB or TCEQ for utilities are shown in **Figure 2**. These plans and reports are considered in the development of the regional water plans that are integrated into the SWP. 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 water conservation plan to TWDB. Water conservation plans must also be submitted as part of applications for new water rights and in some cases, for amendments to currently existing water rights.

Water conservation plans must contain a series of elements, defined in the Texas Water Code, Chapter 11, and the Texas Administrative Code, Title 30, Chapter 288, including:

- utility profile;
- specification of conservation goals;
- specific, quantified 5-year and 10-year targets for water savings;
- metering devices with accuracy of +/- 5 percent;
- universal metering;
- measures to quantify unaccounted for water;
- public education and information program;
- non-promotional rate structure;

FIGURE 2
REQUIRED DOCUMENT SUBMITTALS, FISCAL YEAR 2012

REPORT	ENTITY REQUIRED TO REPORT	REPORT DUE DATE	TEXAS ADMINISTRATIVE CODE, TITLE 31
Water conservation plan	Entities with loans greater than $500,000 (Texas Water Development Board), 3,300 utility connections or greater (Texas Water Development Board), a non-irrigation surface water right greater than 1,000 ac-ft/yr (Texas Commission on Environmental Quality), or an irrigation surface water right greater than 10,000 ac-ft/yr (Texas Commission On Environmental Quality).	Plans are revised every five years. The next revision is due to the Texas Water Development Board, May 1, 2014. Texas Water Development Board shall be provided a copy of Plans submitted to the Texas Commission On Environmental Quality.	Chapter 363, Subchapter A, Rule 363.15/Texas Water Code, 15.106(b)
Water conservation plan Annual Report	All entities with a water conservation plan.	Reports are due to the Texas Water Development Board every year by May 1st.	Chapter 363, Subchapter A, Rule 363.15(g)
Water Loss Audit	All entities with retail water connections.	Reports are due to the Texas Water Development Board every year starting May 1, 2013, for financial assistance recipients. Otherwise, reports are due every five years. The next submittal is due May 1, 2016.	Chapter 358, Subchapter B, Rule 358.6/Texas Water Code, 16.0121
Water Use Survey	Entities that have received a letter, typically municipalities with a population of 25 or greater, or high volume industrial water use.	Surveys are due every year, 60 days after receiving a letter.	Chapter 358, Subchapter B, Rule 358.5/Texas Water Code, 16.012(m)

Sources: Texas Water Development Board; Texas Commission on Environmental Quality.

- documentation of coordination with regional water planning group(s); and
- official adoption of plan and means of enforcement.

TCEQ may require the water supplier to implement additional strategies if it determines that the strategy is necessary to achieve the goals of the water conservation plan.

Water conservation plans submitted to one agency must also be accepted by the other agency. TWDB and TCEQ can both reject the submission of a conservation plan if the plan is incomplete. The agencies, however, have encountered plan submissions that are technically complete but that contain what they have described as potentially arbitrary goals or reporting figures.

The first annual water conservation plans were due May 1, 2010. Because of this date, it is difficult to identify trends in conservation progress. According to the TWDB, 278 annual water conservation plans were received for 2009, and 386 annual reports were received for 2010. For 2010, approximately 55 percent of the reporting entities reached their five-year goals for reducing their GPCD and their water loss.

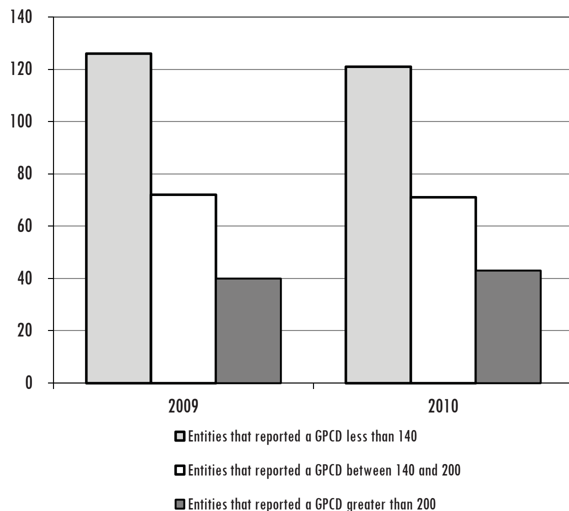
Water conservation plan data is reviewed for consistency regarding past water use, historic water loss, type of customer base, and set targets and goals. TWDB staff contact the entity regarding any inconsistencies based on the requirements of the Texas Administrative Code, Chapter 288. The entity is requested to make those revisions before its plan is accepted. Entities required to submit a water conservation plan or annual report but do not, are contacted by phone and mail by TWDB staff regarding submittal requirements and are offered support by staff. If there is no response regarding the required submittals, the TWDB provides that information to TCEQ for enforcement. According to the WCAC, the quality of reporting varies as entities approach the report with various levels of interest and technological capability, which may lead to inconsistencies among plans. While planning and reporting of water conservation is not required of all water users, the TWDB estimates that water conservation plans encompass about 80 percent of municipal water use.

GALLONS PER CAPITA PER DAY METRIC

Water savings may be quantified through a reduction in gallons per capita per day (GPCD). As stated in the report entitled *"An Assessment of Water Conservation,"* performed by

TWDB and the Texas State Soil and Water Conservation Board, GPCD is the traditional measurement for projecting water demand and evaluating the relative water efficiency of communities. This metric can be used as a planning tool to project the amount of water needed to sustain a population. **Figure 3** shows data related to GPCD, as submitted in recent Water Conservation Annual Reports.

FIGURE 3
TOTAL GALLONS PER CAPITA PER DAY AS REPORTED IN ANNUAL REPORTS, FISCAL YEARS 2009 AND 2010



Source: Texas Water Development Board.

GPCD, however, can sometimes be an imperfect metric as there can be limitations in how GPCD can be compared from one community to another. Methods for determining a baseline service population can vary. The disparate nature of various communities, their economic industries, and the climactic attributes of their geographic region of the state also complicate comparisons. According to *"An Assessment of Water Conservation,"* per capita water use tends to be higher in cities with: more arid climates; more non-residential businesses; higher growth areas requiring more new building construction; lower cost of water; higher-income residents; more commuters or other part-time residents; and with more aging infrastructure.

The passage of Senate Bill 181, Eighty-second Legislature, Regular Session, 2011, begins to address the problem of a standardized GPCD methodology. The bill directs TWDB, in consultation with TCEQ and the Water Conservation Advisory Council (WCAC), to develop a standard formula for calculating and reporting municipal water use in GPCD. The legislation established criteria to guide the formulation of a GPCD metric, and required TWDB, TCEQ, and WCAC to develop a data collection and reporting program to assist municipalities and water utilities in using the GPCD formula. Before the passage of Senate Bill 181, there was no standardized statewide methodology for calculating per capita usage. Therefore, it has been difficult to evaluate success in conservation plan implementation. A standardized method for calculating GPCD will be in place in fiscal year 2013.

TRACKING STRATEGY IMPLEMENTATION

In the 2012 SWP, 14 of the 16 regional water-planning groups identified conservation strategies that would assist in meeting supply needs. As such, it is in the interest of the state to track and measure the implementation of water conservation strategies. There is no specific process available to track the implementation of water management strategies accurately and the cost savings achieved.

The Eightieth Legislature, 2007, passed legislation that requires TWDB to give funding priority to water supply projects in the SWP. Priority is given to project applicants that have already demonstrated or are expected to achieve significant water conservation savings by implementing the proposed project. The State Auditor's Office (SAO) conducted an audit on the Water Infrastructure Fund at TWDB, released in July, 2012. SAO recommended that the TWDB develop documented policies and procedures to determine how to compile water use data and calculate water conservation savings. Also, the report states that TWDB should strengthen the accuracy of Water Use Survey data and its water conservation savings calculations.

Current reporting requirements do not gauge the effectiveness of implemented conservation measures. Water conservation plans, according to TWDB staff, typically do not include up-to-date population and customer water use data. The predicted savings of implemented strategies cannot be verified without the proper methodology and tools. According to the WCAC, planning groups indicated that enhancements to existing reporting mechanisms along with the consolidation of reporting requirements would help identify the implementation of water conservation at the regional level. In addition to TWDB reporting requirements, municipal providers may also be statutorily required to report related data to TCEQ, their regional water planning group, their local governing body, and the utility's wholesale water provider. This level of reporting can become duplicative

and at times redundant. Developing a common reporting system that governmental and nongovernmental entities would design and to which they would all have access would streamline reporting. TWDB has received periodic feedback about filling out different paperwork for Water Use Surveys, annual water loss reports, and annual water conservation reports instead of having a single survey.

Recommendation 3 would increase appropriations to the Texas Water Development Board by $0.7 million of General Revenue Funds in Strategy A.2.2, Water Resources Planning, in the 2014–15 General Appropriations Bill and include a rider to direct the use of these funds for improvements in data collection and management relating to utility conservation implementation. The recommendation would streamline reporting requirements related to water management and planning into a central, online reporting tool. TWDB should develop a process for these reports to be completed, submitted, and viewable by the public on-line. Recommendation 3 also includes the development of an approach to standardize and improve provider-level water use data and conservation savings estimates. This recommendation is consistent with that of five regional planning groups as listed in Appendix D of the State Water Plan to fund improvements in data collection and management.

In 2012, BBC Research and Consulting delivered a report to the TWDB entitled "Water Conservation Savings Quantification Study." The study began in 2010 and was aimed at identifying and evaluating potential methods to assist in evaluating actual conservation savings. According to BBC Research and Consulting, an approach for estimating statewide and regional water conservation savings would be to develop a statistical analysis based on municipal water use data. This analysis would attempt to control for the effects of factors that influence water demand, such as weather and economic conditions. A GPCD calculator is being developed by WCAC, per the provisions of Senate Bill 181, Eighty-second Legislature, Regular Session, 2011. This software application may prove to be an effective tool for data collection and water conservation analysis that TWDB could incorporate into this project. TWDB, along with TCEQ and WCAC should actively promote these tools to municipal water providers.

WATER ACCOUNTABILITY AND LOSS CONTROL

Many water utilities in Texas experience a variety of water losses. The primary type of water loss most utilities experience is from leaks that arise in the pipe distribution system. Suppliers may also experience water loss due to unauthorized consumption, meter inaccuracies, or inaccurate accounting of water transfers. These losses have a negative impact on utility revenue and the accuracy of data the utility collects and transmits to the state. During the review of loan applications, TWDB has observed water losses as high as 50 percent for certain systems.

The first step in addressing and improving water losses is to conduct a water audit to identify the nature and volume of loss. Properly executed water auditing and loss control programs assist utilities in the reduction of water loss, improve data reliability, increase the efficiency of the water supply delivery network, and are able to recover revenue that would have been lost otherwise. Wholesale providers who do not directly provide retail water supplies are not required to perform water loss audits, nor are utilities that provide only wastewater collection and treatment services. Water loss audits collect information on potable water treated and provided through a municipal distribution system, rather than water purely bought and sold by entities, and identifies the uses and losses throughout the system.

In 2003, the Seventy-eighth Legislature passed legislation requiring all retail water suppliers to submit a water loss audit to TWDB every five years. TWDB collected water loss audits in fiscal years 2006 and 2011, and the response rate each time was slightly above 50 percent. However, the responses collected represent at least 75 percent of the water volume usage in Texas. House Bill 3090, Eighty-second Legislature, Regular Session, 2011, requires annual water loss audits to be performed by retail public utilities receiving financial assistance from TWDB. In fiscal year 2012, 320 utilities were included in this category. The first of these annual reports for water loss are due May 1, 2013.

In 2010, TWDB asked approximately 3,500 retail water providers to complete a water loss audit worksheet, which could be completed on-line or by hand and mailed to the agency office. TWDB received 1,900 completed audits, the primary type of water loss observed coming from piping distribution system leakage, also known as real losses. Conclusions from these audits published by TWDB include:

- Total reported losses were 843,857 acre-feet, which is 16.7 percent of the system input volume of the reporting utilities.
- Reported losses resulting from inaccurate meters, billing errors, and unauthorized consumption totaled

157,385 acre-feet. This type of loss is termed an apparent loss and represents 18.5 percent of total losses.

- The cost in lost revenue from apparent losses is estimated at $205.1 million dollars, assuming the retail price of water is $4.00 per 1,000 gallons.
- Real loss is a term for leaks and breaks in the distribution system and other unreported system loss. This totaled 691,672 acre-feet, which is 81.5 percent of the total loss in the audits.
- The cost of real losses from undelivered treated water is $450.8 million, assuming the cost of treating water at $2.00 per thousand gallons.

During the 2011 drought, certain Texas municipalities saw an increase in the volume of water lost due to pipeline leaks. As an example, one municipality recorded system water loss of 13.8 percent in June, and then up to a 25.1 percent loss in September of 2011. This increase is due, in part, to significant percentages of the pipeline having outlived its projected useful life. Fifty years is the industry average life expectancy for municipal piping.

Performing and submitting water loss audits every five years reduces the ability of utilities and the state to properly track water consumption and water loss. The infrequency of this reporting also reduces the usefulness of the data contained in those reports as an effective technical resource to aid local governments in minimizing system water loss. Over time, reductions in water unnecessarily lost in the distribution system would increase the supply of water able to be delivered to customers. Recommendation 4 would amend the Texas Water Code, Chapter 16, to require retail public utilities currently subject to a five year audit requirement to perform water loss audits on an annual basis and report this information to TWDB. This is consistent with a recommendation TWDB made in the 2012 SWP. This change would assist in reducing water lost in transmission and aid utilities in increasing their understanding of water management and conservation.

Utilities systems that have significant rates of water loss can apply for additional state assistance to increase water supplies without having to reduce water loss rates. Utilities must report their level of water loss when they apply for financial assistance from TWDB. In 2012, TWDB staff expressed concern regarding water loss levels of utilities applying to the TWDB for financial assistance. TWDB staff will work informally with high water loss applicants if their loss exceeds 17 percent, or real loss exceeds 460 gallons per mile per day for utilities with fewer than 32 connections per mile. For utilities with more than 32 connections per mile, real loss would be in excess of 24 gallons per connection per day.

It would be in the interest of state loan recipients to address present structural improvements in their water delivery system in addition to perceived needed infrastructure improvements. Recommendation 5 would amend the Texas Water Code, Chapter 16, to require TWDB loan recipients to address water loss through a portion of state loan financing received from TWBD, should the agency determine that the water loss in the applicant's system is above a certain threshold. Recipients of state financing for water supply enhancing projects would acquire an additional loan amount from TWDB to address their system water loss. TWDB would, by rule, establish appropriate thresholds and procedures for determining application of the requirement.

DROUGHT PLAN IMPLEMENTATION

Public water systems are required to have a drought contingency plan ready in case of drought or similar water shortages. Texas experiences drought conditions on a reoccurring basis. Because of this, it is vital for the state to adequately prepare for the allocation and conservation of water during these times. Drought management strategies are temporary measures that are used to reduce water demand during a drought. All public water suppliers and irrigation districts must include these measures in drought contingency plans as the Texas Water Code requires. Water suppliers are required to notify TCEQ of the implementation of any mandatory provisions of their drought contingency plan. Regional water planning groups include drought contingency plan information when developing their projections of future water supply and demand needs in their region. If these plans are not enacted during a drought, this negatively affects the accuracy of projections by regional planning groups.

During times of drought, individual water suppliers autonomously determine the triggers for voluntary and mandatory water use restrictions and outline these triggers in their drought contingency plans. These can be adjusted as often as needed each year depending on supply and demand conditions. When drought conditions are present and last for a significant duration, normal or excessive consumption further exasperates the situation.

The state's worst single-year drought in history was in 2011. Statewide reservoir storage was at its lowest point since 1978

and agricultural losses exceeded $7 billion. Residents of some of the largest cities increased their water usage, despite the widespread adoption of restrictions on lawn-watering. In many cases this is due to an increase in outdoor watering to compensate for the hot, dry drought conditions.

According to the U.S. Drought Monitor and TCEQ drought-affected public water supply (PWS) systems maps, as of October 4, 2011, exceptional drought conditions affected 88 percent of the state. An exceptional drought condition is the highest level of drought intensity the U.S. Federal Drought Monitor can assign. All areas of the state were in one of the five drought categories. During the summer months of 2011, of the 4,721 active community water systems in Texas, only 931 implemented drought restrictions (either voluntary or mandatory). Of the 931 systems, 684 use groundwater either exclusively or partially. Only 55 reportedly banned all outside watering.

In August of 2011, one of the largest financial applicants for SWP assistance, announced mandatory restrictions on its outdoor water use. The U.S. Drought Monitor classified the county as being in 100 percent extreme drought for four months prior to this action. The behavior of this metropolitan area was not uncommon among local entities during the 2011 drought. At the same time, approximately 11 percent of Texas water systems reported that mandatory restrictions were in effect, and another 6 percent had voluntary constraints.

If the Governor declares a drought emergency proclamation, the county(s) listed in the declaration is required to notify each entity that is required to develop a water conservation plan about the declaration. By statute, the entity is required to implement its water conservation plan or drought contingency plan immediately. On July 5, 2011, the Governor issued a disaster proclamation for threat of extreme wildfires and exceptional drought conditions. This proclamation applied to all 254 counties in the state. Only a fraction of entities subject to this proclamation reported to TCEQ that they enacted any drought restrictions. A possible explanation for this behavior is that those entities chose to implement their water conservation plans instead of their drought contingency plan. Water conservation plans should always be implemented, irrespective of drought conditions. Water conservation plans are intended to address water use efficiency and long-term water use. Drought contingency plans are intended to address a short-term need due to climatic or emergency conditions. Recommendation 6 would amend the Texas Water Code, Chapter 16, to require local entities to implement their drought contingency plan upon the issuance of an Emergency Disaster Proclamation related to exceptional drought conditions by the Governor.

The responsible management of water by local entities should be a condition for receiving state financing to assist in local water infrastructure investments. Recommendation 7 would amend the Texas Water Code, Chapter 17, to require TWDB to consider an applicant's compliance in implementing their drought contingency plan. This recommendation would be applicable prospectively for future applications received by the TWDB and based on adherence to future drought conditions. TWDB should give a negative determination of funding to entities that have not satisfactorily implemented their drought contingency plan during a time of drought, as declared by the Governor's drought proclamation. Increased compliance by local entities with their own conservation and drought contingency plans would enhance the effectiveness of those plans. This compliance would in turn yield a greater degree of effective water management among local governments. The more consistently these plans are adhered to, the more accurate and effective regional planning can be. This recommendation is consistent with the recommendations of regional planning groups in the SWP that encourage municipal providers to meet current requirements. Additionally, this recommendation clarifies the relationship between drought contingency plans and the regional planning process.

RESEARCH AND DEVELOPMENT FOR WATER TECHNOLOGIES

Municipal water users are one of the fastest growing water user groups of the Texas economy. However, there is little water conservation research or education being directed at these sectors in institutions of higher education in Texas. Several Texas universities do however, operate research and academic programs relating to agriculture best practices and economic impacts of increased water efficiency.

Additionally, several Texas universities are also engaged in similar levels of energy efficiency research and have incorporated that research into their academic curriculum. As stated in the 2012 report *An Assessment of Water Conservation*, submitted by TWDB and Texas State Soil and Water Conservation Board (TSSWCB) to the Eighty-second Legislature, Regular Session, 2011:

> "There is a need to provide incentives for the creation of higher institutional research and academic programs relating to water conservation and water resources

> planning. More research in the areas of municipal, commercial, industrial, and institutional water use sectors is needed. Additionally, there is a need for more academic programs that will produce trained water resource planning professionals."

The TWDB administers the Innovative Water Technologies program. The mission of Innovative Water Technologies is to educate the water community on the use of nontraditional water supplies. According to TWDB, this is accomplished through advancing technology demonstration projects; developing publications and informational materials; and making public presentations on these materials. The agency promotes research related to aquifer storage and recovery, rainwater and storm water harvesting, and water reuse through grants for research and demonstration projects and outreach activities. The TWDB offers grants for water research that addresses research topics published in the agency's Request for Proposals. This water research program, typically budgeted $600,000 in General Revenue Funds per fiscal year, is funded through TWDB's Water Resources Planning strategy. Research also includes activities related to the development and demonstration of products, to solve any technical problems that might arise post-research.

Additional research and development could help better inform local decision-making. Additional progress in this field would assist in making new technologies available to increase the effectiveness of water management in the state. Examples include improvements in recycling and reusing water and discerning suitable environments for aquifer storage and recovery.

WATER REUSE AND RECYCLING

Water management strategies in the SWP involving reuse could provide up to 915,600 acre-feet of water per year by 2060, or 10.2 percent of all SWP strategies. The two types of water reuse are direct and indirect reuse. Direct reuse is the use of effluent that is piped directly from a wastewater treatment plant to the place where it is used. Indirect reuse is use of treated wastewater effluent that is discharged into a lake, river, or stream and then diverted further downstream to be used again. This process, along with any use of surface water, requires a permit from the state. Using reused water for beneficial purposes is regulated by TCEQ by the Texas Administrative Code, Title 30, Chapter 210. Texas Administrative Code, Chapters 295 and 297 establish the rules and process for application and issuance of surface water rights.

According to TWDB, direct reuse is usually implemented only for non-potable purposes, such as irrigation of golf courses or agricultural space. Direct reuse for potable purposes has only recently begun to be considered and as of 2012 there few places in the U.S. where it is permitted; one of which is Big Spring, Texas. The Big Spring process is a pipe-to-pipe treatment, mixing highly treated reclaimed wastewater effluent with raw surface water prior to drinking water treatment. The project provides a permitting precedent for future water reuse projects in the state. The permitting of direct potable reuse is a thorough process to allow for the careful consideration of public safety concerns. Technologies that are likely to be used for direct reuse may also require pilot testing to ensure that the right treatment regime is selected.

In 2009, TWDB awarded a research study grant to assess past accomplishments in implementing water reuse, as well as identify present needs. One report to be produced through this process was the Water Reuse Research Agenda. The agenda was generated with input from a nationally recognized panel of water reuse experts. Its recommendations pertain to practical research issues that are immediately applicable to Texas. The top seven water research priorities, as provided in the document, primarily are focused on indirect potable reuse and range from understanding the role of environmental buffers in the surface water reuse projects to the use of managed aquifer recharge systems and improved data and modeling capabilities.

AQUIFER STORAGE AND RECOVERY

According to a 2011 TWDB report entitled "An Assessment of Aquifer Storage and Recovery in Texas," storage of water above ground in surface reservoirs is problematic due to adverse environmental impacts, land requirements, high costs, and water losses due to evaporation, transpiration and siltation. Storing water underground, however, can provide a significant portion of the storage needed to meet future demand in certain regions of the state. This process is called aquifer storage and recovery (ASR). The TWDB report suggests several areas related to ASR that, if improved, could increase the use of this technology.

More information is needed to identify the best locations for future ASR development. Conversely, additional information is also needed to identify areas where this is not a technically feasible prospect. The TWDB report recommends the establishment of an ASR demonstration program to increase the number of ASR projects in operation. This program

would provide for measures that would increase the data gathering needed to improve the technical, legal, and educational framework in support of ASR. Demonstration projects, alongside research and further study of this subject would further increase the ability to implement this water management strategy.

NEW TEXAS WATER RESEARCH CENTERS

Texas State University-San Marcos is developing a $10 million center, to be known as the Meadows Center for Water and the Environment, which will conduct water research. As of 2012, the university has received approximately $1 million in financial gifts to help develop the center. When fully funded, the center will include a conservation leadership endowment to sustain the center's director, chairs, and professorships.

Texas A&M is also forming a Water Conservation and Technology Center to address water concerns. The Texas Water Resources Institute, an entity of the Texas A&M System, will be the administrator of the center. Its purpose will be to increase improve the state's ability to meet statewide water needs through water conservation and technology. According to Texas A&M, priorities for research include: water conservation, water reuse, energy development, and groundwater desalination. This research will occur in partnership with state and federal agencies, as well as municipalities, industry, trade associations, and other research institutions. The partnerships will undertake projects and develop solutions within these four areas.

According to TWDB, the state's demand for water is projected to exceed supply from conventional surface water and groundwater sources. The state may need to identify new cost-effective and likely conservation-oriented sources of water to meet the shortages. Thirteen regional water planning groups have recommended non-conventional water management strategies such as water reuse, desalination, and aquifer storage and recovery to meet, at least partly, these shortages. However, for a number of reasons including scarcity of data and shortage of experience, implementing non-conventional strategies is challenging.

Recommendation 8 would increase appropriations to the Texas Water Development Board by $3.7 million of General Revenue Funds in Strategy A.2.2, Water Resources Planning, in the 2014–15 General Appropriations Bill and include a rider to direct the use of these funds for grants related to the reuse and recycling of water, as well as other efforts that would benefit the state's knowledge and management of water through the Innovative Water Technologies program. TWDB should fund research and development programs, primarily related to the reuse and recycling of water, as well as other areas that would benefit the state's knowledge and management of water. Institutions of higher education or other qualifying entities would be eligible to receive grants to further their independent research related to water management. Providing TWDB with decision-making authority to select grant recipients will align projects with priorities of the SWP. This recommendation is consistent with that of three regional planning groups as listed in Appendix D of the State Water Plan to advance conservation technologies.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendation 1 would increase appropriations for water conservation education through the Water IQ program at TWDB. This would result in a cost of $6 million for the 2014–15 biennium and $3.0 million per fiscal year thereafter. The five-year fiscal impact of this recommendation is shown in **Figure 4**. Funding would support the development of a public information campaign as well as allocated for stakeholder research, informational materials, promotional literature, and public events.

FIGURE 4
FIVE-YEAR FISCAL IMPACT OF RECOMMENDATIONS 1, 3 AND 8, FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE FUNDS	PROBABLE ADDITION/(REDUCTION) OF FULL-TIME-EQUIVALENT POSITIONS
2014	($5,239,914)	8.75
2015	($5,158,974)	8.75
2016	($5,158,974)	8.75
2017	($4,956,974)	5.50
2018	($4,956,974)	5.50

Sources: Legislative Budget Board; Texas Water Development Board.

Recommendation 2 amends the Texas Water Code to require Water Conservation Advisory Council to make specific recommendations on methods to improve water conservation. It is assumed that this could be accomplished within existing resources and no fiscal impact is anticipated.

Recommendation 3 would consolidate TWDB-related reporting requirements into a single online system. According to TWDB, this would require 3.25 full-time-equivalent

(FTE) positions and $202,000 per fiscal year for three years. This represents a cost of $404,000 for the 2014–15 biennium. Recommendation 3 also includes the development of a new platform to standardize and improve provider-level water use data and conservation savings estimates. For estimating actual statewide and regional water conservation savings, TWDB estimates that the cost for an outside consultant to develop the necessary model would be approximately $60,000. For the annual costs of updating the model, then analyzing, interpreting, and disseminating the results would require 0.5 FTE. TWDB also estimates that the cost for an outside consultant to develop the necessary web-based model for standardizing provider level data would be approximately $110,000. The annual internal cost for hosting the model and storing data would be $10,000. In addition, 1.0 FTE would be required to provide ongoing assistance to local users with limited experience. It should also be noted that TWDB, at their August 2012 Board meeting, committed $100,000 in funding to a new research project "Determining Cost Benefit and Demand Savings of Municipal Water Conservation Efforts," which will potentially cover a portion of the model development aspect of this recommendation. The improved level of data collection and analysis would allow for a greater ability of the state to evaluate actual statewide and regional savings achieved by water conservation projects. The five-year fiscal impact of this recommendation is shown in **Figure 4**.

Recommendation 4 would amend the Texas Water Code to require public water suppliers to conduct annual water loss audits. No fiscal impact to the state is anticipated. An initial examination of the potential cost for water suppliers of acquiring and installing software to accomplish this shows a potential range of $10,000 to $35,000, depending on the complexity and size of the utility. The cost of acquiring and installing this software could be absorbed within existing resources of certain water providers. Others may choose to pass this cost directly on to their customers.

Recommendation 5 would amend the Texas Water Code to authorize TWDB to require the incorporation of funding for local entities to address system water loss. No fiscal impact is anticipated as a result of the recommendation.

Recommendation 6 would amend the Texas Water Code to require the implementation of an entity's drought contingency plan upon declaration by the Governor. No fiscal impact is anticipated.

Recommendation 7 would amend the Texas Water Code to require the TWDB to consider whether entities have complied with their drought contingency plan when considering applications to the state for financial assistance. Compliance history would be factored by the Board into an applicant's prioritization for receiving state financial assistance. This recommendation would be applicable prospectively for future applications received by the TWDB and based on adherence to future drought conditions. This recommendation can be accomplished within existing resources and no fiscal impact is anticipated.

Recommendation 8 would fund research and development programs related to water conservation. This would be directed through the Innovative Water Technologies Program at TWDB. There would be a cost of $3.7 million in the 2014–15 biennium and $1.8 million annually thereafter. Four FTE positions would be added as a result of the recommendation. The five-year fiscal impact of this recommendation is shown in **Figure 4**. This estimate was based on the agency's Legislative Appropriations Request Exceptional Items for Water Research and Planning for the 2014–15 biennium.

The combined implementation of Recommendations 1, 3, and 8 would cost $10.4 million in General Revenue Funds for the 2014–15 biennium. If the Legislature were to create a dedicated source of revenue for SWP projects, such funding could be used in lieu of General Revenue Funds for these purposes.

The impact of these recommendations to local governments would be to increase the effective management of water supplies and strategies to increase municipal water conservation. The fiscal impact to local entities cannot be determined. It is unknown to what degree individual entities will quantifiably increase their water conservation. It is assumed that all recommendations could contribute to long-term cost avoidance to both the state and local governments. Significant levels of conservation could negate the need for additional capital infrastructure investments. Recommendation 4 may involve a one-time cost by certain utilities in software and reporting upgrades.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

IMPROVE UTILITY REPORTING TO ENSURE STATE ENTITIES ARE EFFECTIVELY MANAGING WATER USE

State entities, including agencies and public institutions of higher education, have traditionally focused their construction and maintenance practices on energy efficiency. State law and executive order mandate energy conservation. Financing to retrofit state buildings is available through energy-savings-performance contracts. These contracts allow upgrades to be paid for from savings generated by the projects.

Water conservation by state entities is becoming more important due to recent drought conditions and an increase in overall utility expenditures for water. Water usage cost Texas state agencies and public institutions of higher education approximately $33.7 million in fiscal year 2011. To assist state entities in being good stewards of this resource, the State Energy Conservation Office, a division of the Comptroller of Public Accounts, produces guidelines and standards for new building construction and major renovations. Other resources for research and technical assistance, including best management practices guides, are available for reference by facility managers. These guidelines have helped the state reduce and conserve water use at state facilities in a cost-effective manner.

Not all utility reporting requirements for state entities include water use and conservation as required elements. A consolidated approach to compiling and tracking agency progress in utility conservation activities could better inform future policy actions. Additionally, tracking this information could lead to increased efforts in water conservation by all state entities and reduce costs.

FACTS AND FINDINGS

- ♦ Water usage cost for state agencies and public institutions of higher education was approximately $33.7 million in fiscal year 2011; 11.7 percent of total state agency utility expenditures. This cost represents a 12.6 percent increase from fiscal year 2010. In contrast, the cost of electricity to the state increased by 2.4 percent during this period.
- ♦ State entities can take advantage of many effective water conservation strategies. These range from xeriscaping to improved water use monitoring. State entities can finance retrofit and water system upgrades using energy-savings-performance contracts. These may assist in significantly reducing capital costs and tie loan repayments with achieved utility savings.
- ♦ State entities may receive technical assistance from the State Energy Conservation Office or research grants from the Texas Water Development Board. These grants may be used to assist in identifying problem areas in agency water delivery systems.

CONCERN

- ♦ A decline in state entity water conservation reporting has occurred because of conflicting reporting requirements. This lack of reporting inhibits the state in gauging the effectiveness of current conservation measures. State entities may also be unaware of opportunities available to enhance their utility conservation efforts.

RECOMMENDATION

- ♦ **Recommendation 1:** Amend statute to codify certain provisions of the 2005 Executive Order relating to state agency energy savings program reporting requirements in order to increase the ability of agencies to gauge the effectiveness of water conservation measures and potentially enhance future conservation activities.

DISCUSSION

As population and economic activity in Texas increases, so does the demand on the state's limited availability of fresh water supplies. The state can encourage water conservation and efficiency by setting an example for how conservation may be accomplished in a feasible and cost-effective manner. Steps have been taken to ensure that new state buildings constructed or that undergo major renovation (defined by the State Energy Conservation Office [SECO], a division of the Comptroller of Public Accounts, as costs in excess of $2 million) adhere to conservation standards set in statute and through standards and guidelines published by SECO.

WATER USAGE IN STATE FACILITIES

State entities, including state agencies and public educational institution facilities, typically consist of single buildings,

campuses, or real estate complexes. State entity buildings are typically referred to as commercial buildings as they are primarily for office use or warehouse purposes. Water consumption by these users varies by the volume of use, rate of use, and subsequent opportunities for efficiency. The six following areas represent where most water use occurs for commercial and institutional users: restrooms, laundries, cooling and heating, landscapes, recreation, and kitchens. According to SECO, the state spent an average of $26.0 million annually on water utility bills from 1997 to 2005. In fiscal year 2011, water usage accounted for approximately 11.7 percent of total state agency utility costs, or $33.7 million, a 12.6 percent increase from fiscal year 2010. In contrast, the cost of electricity to the state increased by 2.4 percent during this period. A breakdown of fiscal year water expenditures for the ten agencies with the most registered buildings is shown in **Figure 1**. These costs are predominately paid for with General Revenue Funds, although the methods of finance vary by individual agency. Utilities may also be paid with General Revenue–Dedicated Funds, Federal Funds, Other Funds, or a combination thereof.

Variations in water usage can also be seasonal, as shown in **Figure 2**. Increased consumption in the warmer months of the year is typical for most sectors, including commercial and institutional users.

State entity water utility expenditures are influenced by standards promulgated by two agencies: the Texas Facilities Commission (TFC) and SECO. These agencies are responsible for encouraging the use of effective standards and guidelines for utility management by all entities, as well as requiring that the new construction or renovation of agency buildings satisfy certain conservation thresholds.

FIGURE 1
ANNUAL WATER EXPENDITURES BY AGENCY
FISCAL YEAR 2008

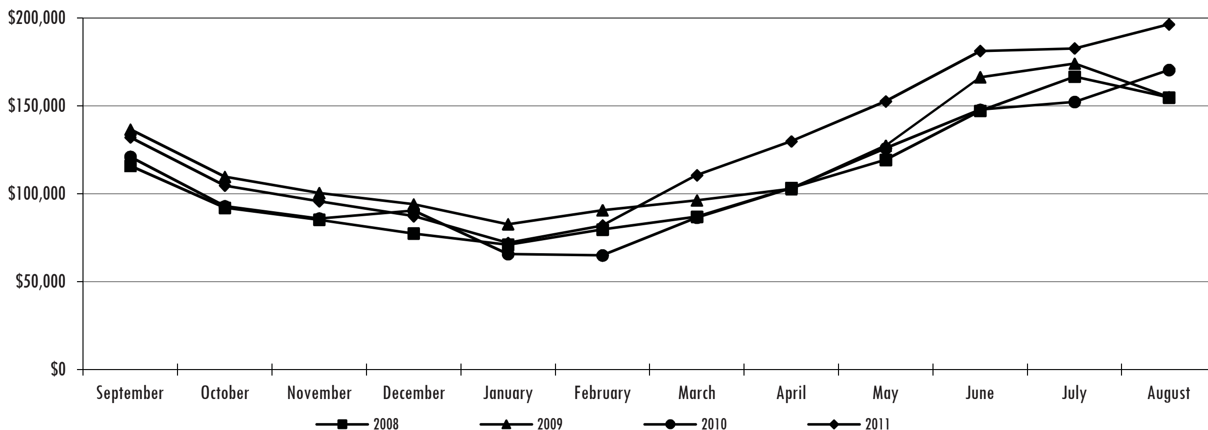
AGENCY	TOTAL BUILDINGS	ANNUAL WATER EXPENDITURES
Texas Department of Criminal Justice	3,067	$20,661,340
Texas Department of Transportation	1,177	$2,243,247
Texas Facilities Commission*	63	$1,483,383
Texas Parks and Wildlife Department	1,552	$636,087
Adjutant General's Office	231	$342,262
Texas Department of Public Safety	191	$287,233
Health and Human Services Commission	934	$216,413
Texas Workforce Commission	28	$64,209
Texas Historical Commission	16	$38,304

*Does not account for parking facilities, which the Texas Facilities Commission regards as part of its facilities profile.
Source: Legislative Budget Board.

TEXAS FACILITIES COMMISSION CONSERVATION RESPONSIBILITIES

The Texas Government Code requires TFC to adopt guidelines for the required use of xeriscape on state property

FIGURE 2
TEXAS FACILITIES COMMISSION MONTHLY UTILITY CHARGES
FISCAL YEARS 2008 TO 2011



Sources: Legislative Budget Board; Texas Facilities Commission.

associated with the construction of a new state building, structure, or facility that began on or after January 1, 1994. Several buildings have been constructed since this time, including the Robert E. Johnson Building, a laboratory for the Department of State Health Services and the Truan Natural Resource Center in Corpus Christi. TFC has adopted xeriscaping guidelines, as part of the agency's Architectural and Engineering Design Guidelines, which require designers to pursue landscape designs that are drought resistant and conserve water. Additionally, Texas Government Code requires TFC to develop a five-year plan for phasing in the use of xeriscape on state property associated with a state-owned building, structure, or facility on which construction began before January 1, 1994. As funding has been made available, the agency has taken a systematic approach to the redesign and xeriscaping of state land when possible. Several xeriscape projects completed by TFC in the last several years have ranged from $7,100 to $37,000.

Water usage by state entities and state-owned buildings is measured only through utility bill audits and reviews done by agency or facilities management divisions. Utility bills are typically reviewed by TFC and other consuming entities for anomalies that may be an indication of a failing system or piece of equipment, or for operations or practices that may not be conservative. It is unknown how often individual entities perform such audits and the extent of the audits. Statute requires all state entities, including agencies and public institutions of higher education, to perform utility billing audits every four years to ensure that utility providers are billing correctly.

Adherence to local water conservation regulations is not required on state-owned land. However, TFC follows a "good neighbor" policy, especially in times of drought, meaning that the agency complies with local restrictions or ordinances and adapts water use to accommodate those policies.

According to TFC, examples of potential areas that state entities can pursue to reduce water consumption in a cost-neutral manner are:

- minimize/eliminate irrigation, but protect trees;
- install rain sensors in automatic irrigation systems;
- install shower heads rated for 1.5 gallons per minute (GPM) flow;
- replace aerators on faucets for more efficient flows;
- develop policy for replacing landscaping with drought resistant plants; and
- install motion sensor fixtures.

STATE ENERGY CONSERVATION OFFICE RESPONSIBILITIES

SECO is responsible for adopting water standards for construction of new state facilities and can perform utility audits for entities to help them identify areas where they can conserve water. The agency, seeking to provide guidance and resources for lowering energy costs and maximizing efficiency, focuses on new construction and major renovation projects. New construction is the most cost-effective point to establish energy efficiency elements and building energy codes, which serve as a starting point to reduce energy consumption significantly. All new construction of state buildings and public institutions of higher education facilities are required to adhere to SECO Water Efficiency Standards, as directed by legislation passed by the Seventy-seventh Legislature, 2001.

The Eighty-second Legislature, Regular Session, 2011, authorized additional water conservation requirements for new state building construction or major renovation. House Bill 51 established high-performance, sustainable-design standards related to state and higher education buildings. Minimum standards are to achieve a 15 percent reduction in water use compared to relevant plumbing fixtures the federal Energy Policy Act of 1992 identified. The Eighty-second Legislature also passed House Bill 3391, which amended statute to require that rainwater harvesting for both potable and nonpotable indoor use and landscape watering be incorporated into all new state building constructions. Potable refers to a liquid suitable for drinking, whereas nonpotable is not, but may be used for other purposes such as irrigation or in cooling towers. This requirement applies to each new state building with a roof of at least 10,000 square feet or with a roof of at least 50,000 square feet that is in an area with average annual rainfall of 20 inches or more.

As a result of the 2002 SECO Water Conservation Guidelines and the updated and renamed *2011 Water Efficiency Standards for State Buildings and Institutions of Higher Education Facilities*, water conservation must be considered when designing a new state building or undertaking a major renovation of the following existing state building systems:

- irrigation and landscape;
- heating ventilation/air conditioning (HVAC);
- refrigeration and water treatment;

- rainwater harvesting/reclaimed water/recycled water and reuse;
- plumbing fixtures;
- laundry equipment;
- food equipment;
- pump systems;
- auto services/vehicle washing;
- lab/photo/med facilities;
- pools/spas; and
- special water features.

CONSERVATION EDUCATION FOR COMMERCIAL AND INDUSTRIAL USERS

The state has education programs that are available to facility managers and agency employees to help entities reduce their water use. TWDB's conservation division provides leadership, planning, financial assistance, information, and education for the conservation and responsible development of water. As part of this effort, the Industrial, Commercial, Institutional (ICI) program was established to assist ICI stakeholders in the improvement of their water efficiency. TWDB is able to provide, upon request, technical assistance, informational brochures, and workshops to entities across the state, including state agencies.

UTILITY AUDITS

One tool SECO can use to help state entities reduce their water use is a utility audit. Utility audits allow an entity to evaluate their usage patterns and address any anomalies that may exist in their usage. Audits may present opportunities to increase conservation and subsequently reduce future utility expenditures. A state entity may request to have their utility usage and resource management policies audited by SECO. SECO also has the statutory authority to conduct utility audits at its discretion. These audits, however, are seldom requested by or performed for state agencies due to their cost. SECO provides this service at no cost to the participating public entity but must expend money to produce the assessment. In fiscal year 2011, SECO paid consulting engineers an average of $.015/square foot to conduct these assessments for schools and local governments. One firm conducted 47 assessments covering 32.8 million square feet, and was paid $481,506 for those contracts, or approximately $15,000 per million square feet of assessed space. A parametric estimate would equate to a potential cost of $90,000 to perform an audit of the entire TFC office-building portfolio.

In 2001, SECO conducted an energy audit on the Lyndon B. Johnson Building in Austin, Texas. Water use was determined to be average for a building of this type. Recommended water conservation measures were low-flow toilets, urinals, and faucet aerators. The recommended measures would have cost $83,560, and generated annual savings of $15,185. The time in which those costs were recouped (payback period) was estimated to be 5.5 years, as shown in **Figure 3**.

TECHNOLOGY REFERENCES AND STANDARDS

SECO is also responsible for selecting building standards for new state facility construction. The Texas Government Code directs SECO to establish mandatory energy and water conservation design standards for each new state building or major renovation project. This requirement includes a new building or major renovation project for state-supported institutions of higher education.

The American Society of Heating, Refrigerating and Air Conditioning Engineers (ASHRAE) examine building systems, energy efficiency, air quality, refrigeration and sustainability. ASHRAE publishes standards that address these areas for increased conservation and sustainability. These standards are used as a reference for building codes. They are also used by consulting engineers, mechanical contractors, architects, and government agencies, including SECO. SECO references ASHRAE in fulfilling energy conservation design standards.

A separate water conservation design standard (Water Efficiency Standards for State Buildings and Institutions of Higher Education Facilities) was also adopted by SECO in 2011. Statute also requires SECO to coordinate on all water conservation-related activities with TWDB. SECO worked closely with TWDB on the development of the 2011 Water Efficiency Standards. These guidelines assist entities in identifying potential strategies that could achieve significant conservation savings.

ENERGY SAVINGS FINANCING OPTIONS

The state also provides for access to a variety of financing options to encourage entities to pursue conservation projects. These include energy-savings-performance contracts (ESPCs), the Master Lease Purchase Program (MLPP) at the Texas Public Finance Authority (TPFA), and SECO's

FIGURE 3
ENERGY COST REDUCTION MEASURES (ECRM) FOR THE LYNDON B. JOHNSON BUILDING, FISCAL YEAR 2001

ECRM	ECRM TITLE	TOTAL ANNUAL SAVINGS (ENERGY PLUS OPERATIONS AND MAINTENANCE)	TOTAL INSTALLED PRICE	PAYBACK PERIOD (YEARS)
1	Lighting Retrofit	$62,133	$252,337	4.1
2	Central Plant Motor Replacement	1,558	30,170	19.4
3	Window Film Application	17,187	144,531	8.4
4	Lighting Control	3,949	16,335	4.1
5	Water Conservation	15,185	83,560	5.5
6	Change 4th Floor HVAC Configuration	16,998	255,464	15.0
7	UPS	17,037	131,210	7.7
8	Replace two Existing Chillers	79,592	1,474,913	18.5
9	Optimize Secondary LBJ CHW Loop	27,197	182,001	6.7
	Total	**$240,836**	**$2,570,521**	**10.7**

Note: In this case study, water conservation measures have the third fastest payback period of 5.5 years. Water conservation also is the third most affordable option of all strategies presented.
Sources: Legislative Budget Board; State Energy Conservation Office.

LoanSTAR (Saving Taxes and Resources) program. Energy performance contracting (ESPC) is an infrastructure financing method that allows a facility to complete energy-saving improvements within an existing budget by financing them with monies saved through reduced utility expenditures. Facilities make no up-front investments and instead finance projects through guaranteed annual energy savings.

TPFA borrows money to pay for an agency's equipment or other projects by issuing tax exempt revenue commercial paper notes. The MLPP may be used to finance the acquisition of equipment at a minimum cost of $10,000 and that has a useful life of at least three years. Requested lease amounts greater than or equal to $250,000 for a term of five years or more would require approval by the Bond Review Board. Agencies including the Department of State Health Services and the Department of Aging and Disability Services have multiple leases outstanding through the MLPP.

The Texas LoanSTAR Program is a state-administered revolving loan program. The program's revolving loan mechanism allows borrowers to repay loans through the cost savings generated by the funded projects. The program has issued more than 196 loans, and the average payback period has been 5.7 years. The projects financed have produced a cumulative energy savings of at least $245 million since 1990. The main recipients for LoanSTAR contracts have been public schools, the Health and Human Services Commission, and local governments. Water conservation has been a secondary consideration for the agency ESPC contracts SECO has received. An explanation for this is that energy conservation typically yields greater financial savings, which drives the impetus for pursuing these projects.

ESPCs have a higher total construction cost than traditional design-build and design-bid-build contracts. The higher cost can be attributed to the contractor risk associated with the guaranteed savings part of the contract. Agencies are reluctant to pay this cost increase. SECO has not executed any ESPCs in the past five years. Budget uncertainty may also foster reluctance as an ESPC can have debt obligations up to 15 years, while agency appropriations are made in two-year increments. Also, there is concern appropriations could potentially be reduced for utility budgets. Utility budgets are the source of ESPC debt repayment, so this could put entities farther behind in meeting project debt obligations.

RESEARCH GRANTS FOR CONSERVATION

TWDB also operates a grant program for entities interested in learning the best available options for increasing water conservation. State entities are eligible to receive grants for research projects on conservation or reuse from the Research and Planning Fund. For water research projects, TWDB may award grants for as much as 100 percent of the cost. TWDB has awarded more than $60 million in total research and planning grants. According to TWDB's records, no state entity has applied or been awarded grants from this program, although the benefits to a recipient agency could be significant.

UTILITY CONSERVATION REPORTING REQUIREMENTS

As state entities have latitude in selecting which strategies they employ to conserve water, agencies and public institutions of higher education are required to prepare several reports related to utility conservation and management. After these reporting requirements were developed, they were modified over time and are inconsistent in the scope and frequency of the reporting. A comparison of the basic attributes of these reporting requirements is shown in **Figure 4**.

STATE AGENCY ENERGY SAVINGS PROGRAM

Executive Order RP49 (RP49) was issued in 2005, requiring each state agency to develop a plan for conserving energy and to set a percentage goal for reducing its usage of electricity, gasoline, and natural gas. The order requires each state agency to submit the energy conservation plan to the Legislative Budget Board and the Office of the Governor and report back with its goals achieved, and ideas for additional savings on a quarterly basis. Reports must be posted in a conspicuous place on the agency's website.

RESOURCE EFFICIENCY PLAN

To comply with Chapter 447.009 of the Texas Government Code and Title 34, Chapter 19 of the Texas Administrative Code, entities are required to submit a five-year energy management plan to SECO, which includes a resource efficiency plan (REP) and a long-range utility services plan (LRUSP). This reporting requirement applies to state agencies and public institutions of higher education that occupy state-owned buildings or that otherwise incur utility costs. The REP identifies potential cost effective measures for minimizing utility consumption and costs in all agency facilities and buildings, along with implementation schedules and methods of financing the measures. Utilities included in these reports are electricity, gas, thermal or other energy resource, water, and wastewater. REP status reports are submitted to SECO on a semi-annual basis. Entities must also re-certify the implementation of their REP to SECO every two years. These status reports must contain information related to the progress and reduction in utility costs made through implementation of its REP. Both the REP and LRUSP are required to address energy and water use. For public institutions of higher education, REPS and LRUSPs must be included in their five-year construction and major repair and rehabilitation plans. State entities are required to develop both of these plans but are only required to submit them to SECO upon request by SECO.

EFFECT OF REPORTING REQUIREMENTS

According to SECO, the number of REP reports and certifications required by Texas Government Code, Chapter 447.009, significantly diminished after Executive Order RP49 was issued. SECO reports that most updates received now relate only to the order. RP49 requires state agencies to adopt and pursue goals related to utility conservation. This includes stipulations that agencies must develop a plan and set goals to reduce their usage of gasoline and natural gas. State agencies have neglected other reporting requirements, such as in Texas Government Code, Chapter 447.009, and used the RP49 reporting requirement in lieu of them. An examination of RP49 submissions from 24 separate agencies indicates that almost half do not report on their water usage or water conservation efforts. Additionally, the quality of reporting by agencies as required by the order varies greatly. Agencies failing to compile, actively track, and report information related to their water management may not be

FIGURE 4
ENERGY SAVINGS PROGRAM AND RESOURCE EFFICIENCY PLANNING AND REPORTING REQUIREMENTS, FISCAL YEAR 2012

REPORT NAME	AUTHORIZATION	RECIPIENT	FREQUENCY	WATER	ELECTRICITY	GASOLINE, NATURAL GAS	CONSERVATION GOAL
Energy Savings Program	Executive Order RP49	Office of the Governor, Legislative Budget Board and posted on the internet	Quarterly	No	Yes	Yes	Yes
Resource Efficiency Plan	Texas Government Code, 447.009	State Energy Conservation Office*	Semi-annual** (Status Report)	Yes	Yes	No	No

*Shall also be included in the five-year construction and major repair and rehabilitation plans for institutions of higher education.
**Statute lists reporting frequency as biennial, whereas Texas Administrative Code states semi-annual.
Source: Legislative Budget Board.

able to effectively identify opportunities to maximize their conservation of this resource.

Recommendation 1 would amend the Texas Government Code, Chapter 447.009, to codify certain provisions of Executive Order RP49 and integrate it into provisions relating to REP requirements. The recommendation would not create new reporting requirements, but would require REPs to be submitted to SECO on a semi-annual basis. Reporting requirements will include water, electricity, gasoline, and natural gas. State entities would be required to set their own goals for conservation of these various utilities, as appropriate. SECO would be required to submit a biennial report to the Texas Legislature on the status and effectiveness of utility management and conservation efforts. The report would also be made available online and include data from all reporting entities.

SECO would be required to develop a template for entities to use when submitting reports to the agency. This requirement would add a greater degree of uniformity and allow for an increased level of analysis to be performed by the agency, which is not presently available. The submitting agency or institution would incorporate a series of metrics including utility usage, by building when possible, the square footage of buildings, and other variables used in performing similar analysis in the commercial sector. Entities would already have access to the data as some of it is now reported in publications like the Facilities Master Plan.

Recommendation 1 would establish a mechanism to better track progress made in the conservation and management of various utilities, as well as to better inform policymakers on capital and budgetary matters relating to these issues. Aggregating data from entities could also provide opportunities for collaborative efforts between agencies in pursuing their conservation goals. This would also help raise agency and employee awareness of the relationship between the energy intensity of facility operations and potential savings achieved through improved conservation.

FISCAL IMPACT OF THE RECOMMENDATION

Recommendation 1 would codify certain provisions of Executive Order RP49 into Texas Government Code, Chapter 447. SECO, receiving utility information from all entities, would be required to produce a biennial report reflecting results and progress on utility management and conservation. It is assumed the Comptroller of Public Accounts, through SECO, can perform this duty within existing resources, and no significant fiscal impact is anticipated.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

CLOSE LOOPHOLES RELATED TO THE RENEWAL OF MOTOR VEHICLE REGISTRATION AND INSPECTION

In Texas, the registration and inspection of most passenger vehicles is required to be renewed annually. However, provisions in statute regarding the regular renewal of registration and inspection are inconsistent, and certain statutory gaps make enforcing renewal requirements difficult. When a vehicle's registration is not renewed in compliance with state laws, the state is unable to confirm information that may be needed by law enforcement entities in the vehicle database. When a vehicle's inspection is not renewed on time, the safety and emissions of the vehicle have not been evaluated annually as law requires. Additionally, when drivers do not adhere to inspection and registration renewal requirements, the state loses revenue and scofflaws pay less to use the state's roads than those in compliance. The Texas Department of Motor Vehicles estimates as much as $26 million in State Highway Funds were lost in fiscal year 2010 due to late registration renewals, but the exact loss is unknown.

Improving statutory provisions and processes for registration and inspection renewals would discourage late renewals and close loopholes for vehicle owners that do not comply. As a result, the state could better enforce current measures in place to ensure the safety of Texans and their vehicles, and reduce the state's revenue loss from late renewals.

FACTS AND FINDINGS

- ♦ During vehicle registration renewal, the Department of Motor Vehicles confirms vehicle ownership details in the registration database. Law enforcement entities use information in this database for administration and policing matters such as driver safety and motor vehicle theft. Vehicle registration fees are used to acquire right-of-way and construct, maintain, and police roadways.
- ♦ Vehicle safety inspections verify that vehicles on Texas roadways meet state safety requirements. Vehicle emissions inspections verify vehicles operating in non-attainment and near non-attainment areas comply with smog regulations in adherence with federal law. In these areas the vehicle registration program reinforces this requirement by requiring an emissions test to be completed before registration renewal.
- ♦ It is not possible to determine the exact number of motor vehicles out of compliance with motor vehicle registration or inspection renewal requirements. However, during fiscal year 2011, the Department of Public Safety issued approximately 50,000 citations for inspection violations and approximately 38,000 citations for registration violations.

CONCERNS

- ♦ Several factors diminish the state's ability to maintain accurate vehicle registration records. These include: inconsistencies in the documentation required to validate a reason for late registration, the application of penalties for late registration, and requirements for registration renewal relating to emissions and safety inspections. These factors reduce law enforcement's ability to use vehicle registration data for determining the history and proper owner of a vehicle.
- ♦ Failure to enforce motor vehicle inspection requirements increases the risk that unsafe or high-polluting vehicles are operating on roadways.
- ♦ Inconsistent enforcement of vehicle safety and emissions inspection requirements at the time of registration renewal reduces the enticement to comply with inspection laws, as well as the state's ability to enforce them.
- ♦ The state loses revenue when drivers fail to renew their vehicle registration or inspection by the prescribed renewal date.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Amend statute to strengthen requirements for claiming a valid reason for late registration renewal by requiring an affidavit to be signed as legal verification. This would apply a uniform policy across the state and is similar to the proof required when paying the Motor Vehicle Gift Tax in lieu of Motor Vehicle Sales Tax.
- ♦ **Recommendation 2:** Amend statute to consistently apply the current penalty for late registration renewal to all late registration renewals without a valid reason,

rather than only to persons who have been cited or arrested for driving with an expired registration.

- **Recommendation 3:** Amend statute to disincentivize untimely compliance with registration renewal requirements by restructuring the current delinquency penalty so it increases each month a registration is late.
- **Recommendation 4:** Amend statute to align motor vehicle safety inspection verification with current practices for verifying vehicle emissions testing by requiring that a motor vehicle has successfully passed a safety inspection as a prerequisite for registration renewal.
- **Recommendation 5:** Amend statute to disincentivize untimely compliance with inspection renewal requirements by restructuring the inspection fee so it increases each month a motor vehicle inspection renewal is late. Prorate the expiration date of late renewals so the expiration month will not change from the original inspection expiration date, similar to the manner in which the expiration date of late registration renewals is applied.

DISCUSSION

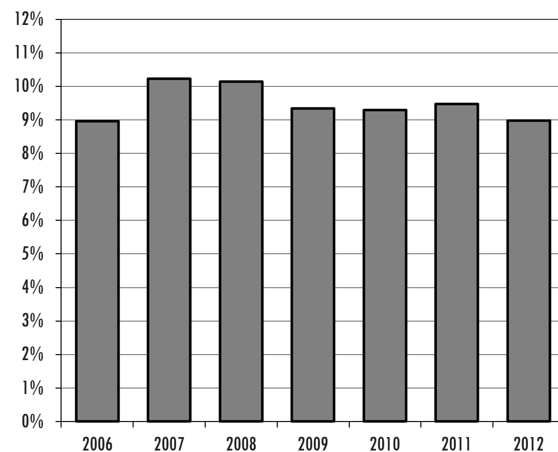
The vehicle registration and inspection programs are intended to improve the safety of vehicles driven on Texas roadways. Each requires proof of compliance. All Texas residents who own motor vehicles used on public highways are required to register their vehicle for each year the vehicle is in use. This requirement allows the Department of Motor Vehicles (DMV) to add or confirm a vehicle's details in the registration database. Incomplete or out of date records reduce the database's effectiveness and the ability to use it to gather vehicle information. Law enforcement entities use this information to verify the ownership of suspected stolen vehicles, the vehicle's history for salvage title purposes, or that a vehicle meets minimum state automobile insurance requirements. The state uses revenue from vehicle registration fees to acquire right-of-way and construct, maintain, and police roadways in accordance with the Texas Constitution.

All passenger vehicles registered in Texas must receive an annual safety inspection. Additionally, gasoline powered vehicles that are 2 to 24 years old and registered in certain counties must be emissions tested annually to comply with smog regulations. Emissions testing is not conducted on diesel powered vehicles or motorcycles.

MOTOR VEHICLE REGISTRATION RENEWALS

DMV reports that from fiscal years 2006 to 2010, an average of 10 percent of motor vehicle registrations were renewed late, as **Figure 1** shows. The agency does not track vehicles that are sold or moved out-of-state, salvaged, a total loss after an accident, or inoperable so there is no way to determine the number of vehicles that do not renew registration. Of the late registrations, an average of 34 percent were renewed one month late and 14 percent were delayed by 12 months or more.

FIGURE 1
PERCENTAGE OF LATE MOTOR VEHICLE REGISTRATION RENEWALS, FISCAL YEARS 2006 TO 2012

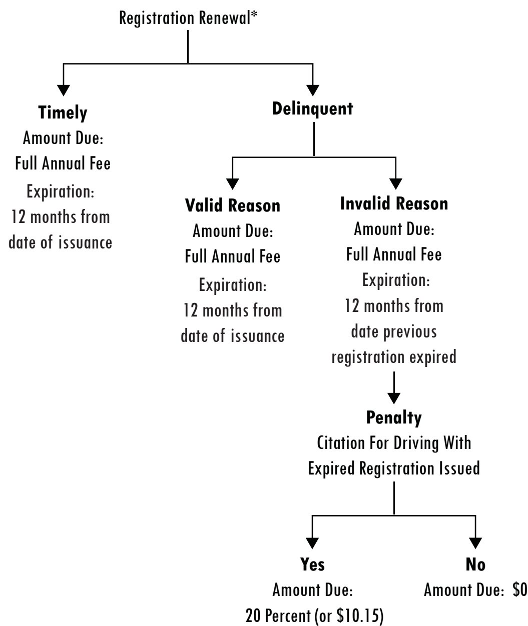


Sources: Legislative Budget Board; Texas Department of Motor Vehicles.

According to DMV, the exact amount of State Highway Funds lost because of untimely registration renewal is unknown, but could have been as high as $26 million in fiscal year 2010. The process of renewing vehicle registrations ensures the state receives all revenue from late renewals. The full 12-month fee is collected when a renewal is completed, but the month of expiration does not change from the original expiration date.

The Texas Transportation Code, Section 502.045, establishes procedures relating to delinquent vehicle registrations. This process is shown in **Figure 2**. Vehicles may be registered late for valid reasons, which are statutorily defined as extensive repairs on the vehicle; absence of the vehicle owner from the country; seasonal use of the vehicle; or any other reason deemed valid by the assessor-collector. Statute allows a county tax assessor-collector to determine whether an

FIGURE 2
PROCESS FOR RENEWING MOTOR VEHICLE REGISTRATION, 2012–13 BIENNIUM



*Registration expires 12 months from the renewal date.
NOTE: A county tax assessor-collector determines delinquency, validation, and whether a penalty should be applied.
SOURCE: Legislative Budget Board.

applicant for a delinquent registration has provided acceptable evidence of a valid reason for late registration. DMV does not have data on the number of late registrations delayed for "valid reasons."

If the assessor-collector finds insufficient evidence is provided to determine whether registration renewal is delinquent for a valid reason, the vehicle must be registered for a 12-month period without changing the initial month of registration. According to the Texas Administrative Code, Sections 217.22(d)(5)(C) and (D), delinquent registrations without a valid reason will be charged the full annual fee and the vehicle registration expiration month will not change from the original registration expiration date.

Legislative Budget Board staff contacted several county tax assessor-collectors who indicated they do not currently request any proof of the existence of a valid reason for late registration and rely on the statement of the vehicle owner. Some counties are now requiring a vehicle registrant to sign an affidavit attesting to the valid reason for which a vehicle's registration is renewed late. Recommendation 1 would amend the Texas Transportation Code to require all persons claiming a valid reason for renewing a vehicle registration late to sign an affidavit as legal verification of the reason for which they are claiming. This requirement would apply a uniform policy across the state and is similar to proof required when paying the Motor Vehicle Gift Tax.

If registrants were cited or arrested for driving with an expired registration, the tax assessor-collector assesses a fine of 20 percent of the registration fee. This penalty does not apply to late registrants that were not cited or arrested for driving with an expired registration. As a result of this inconsistency, late registrants not cited are not penalized despite being delinquent, while late registrants that have been cited pay both a fine or dismissal fee as a result of the citation and the registration penalty of 20 percent. Additionally, county tax assessor-collectors are not notified that a person has received a citation. They rely on the motor vehicle registrant to inform them of a citation or arrest to assess the penalty. As **Figure 3** shows, there is a discrepancy between the number of DPS citations issued for registration violations and the number of late renewals that occur. However, this figure does not include citations local law enforcement entities issued for driving with an expired registration. The total number of late registration renewals subject to the penalty cannot be determined.

Recommendation 2 would amend the Texas Transportation Code to expand the delinquency penalty for driving with an expired registration so it applies to all late registration renewals without a valid reason, rather than only to persons who have been cited or arrested for driving with an expired registration. This recommendation would consistently apply the delinquency penalty to all persons that fail to renew their vehicle registration on time. It would also remove the conflict of interest resulting from relying on the person to whom the delinquency penalty applies to notify county tax

FIGURE 3
VEHICLE REGISTRATION VIOLATIONS AND LATE REGISTRATION RENEWALS, FISCAL YEARS 2006 TO 2011

FISCAL YEAR	REGISTRATION VIOLATIONS	LATE REGISTRATION RENEWALS
2006	30,467	1,725,982
2007	31,676	1,566,305
2008	31,734	1,612,298
2009	36,225	1,829,741
2010	36,892	1,876,757
2011	37,658	1,851,826

SOURCES: Texas Department of Public Safety; Texas Department of Motor Vehicles.

assessor-collectors of a citation or arrest for driving with an expired registration.

The delinquency penalty is the same regardless of how long a person has been driving with an expired registration. The penalty does not change for a person who has been operating a vehicle with an expired registration for 1 month or 10 months. Furthermore, the cost of registration renewal does not vary depending upon how long a vehicle's registration has been expired. As a result, once a registration expires, vehicle owners have no financial incentive to quickly remedy the situation as the cost of renewing is the same regardless of how many months late registration renewal occurs. Recommendation 3 would amend the Texas Transportation Code to restructure the delinquency penalty so it increases each month registration is late.

One option for restructuring the penalty would be to maintain the current base fee of 20 percent, or $10.15, and increase the fee by 5 percent for each additional month the registration is renewed late. Using this structure the maximum delinquency penalty would be 75 percent, or $38.06, for a registration renewed 12 months late. Based on the current annual registration fee of $50.75 and the number of late registration renewals during fiscal years 2006 to 2010, this structure would have generated an average of $32.5 million during each fiscal year since 2006.

MOTOR VEHICLE INSPECTION RENEWALS

The Department of Public Safety (DPS) oversees the motor vehicle safety inspection program and works with the Texas Commission on Environmental Quality (TCEQ) to administer the vehicle emissions testing program. Each vehicle is inspected for adherence to standards DPS developed for safety-related equipment. A passenger vehicle is normally subject to a 20-point inspection and a motorcycle is subject to a 13-point inspection.

Vehicles in 17 counties classified as near- or non-attainment areas, as shown in **Figure 4**, are required to pass an emissions test before their registration may be renewed. With few exceptions, vehicles are required to be tested in the county in which they are registered to ensure the emissions test is not circumvented by going to a county that does not require testing. TCEQ establishes standards for vehicle emissions testing equipment, sets emissions test fees, and captures and analyzes test data. DPS licenses stations, certifies inspectors, conducts station audits, investigates complaints against stations and inspectors, and provides inspector training and certification.

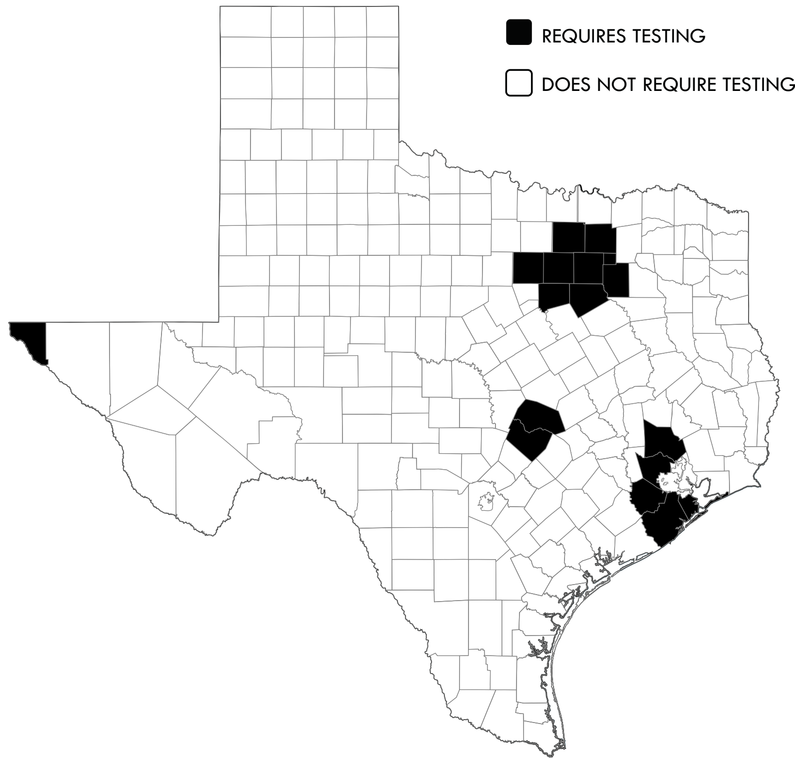
If a vehicle fails an emissions test, TCEQ mails a letter to the vehicle owner. TCEQ reports approximately 3,500 such letters are mailed per month. If a vehicle has not passed an emissions test after the 45-day grace period, its failure is noted in a file sent to DMV. DMV flags the vehicle's record for non-compliance. The vehicle's registration may not be renewed until it passes an emissions test. DMV flags approximately 2,500 vehicle records per month for failing to complete an emissions test. Flags are removed on approximately 1,800 vehicle records per month after they are re-tested.

According to TCEQ, from fiscal years 2006 to 2010, an average of 449,039 vehicles, or 6 percent, receiving emissions inspections failed the initial test. There is no method for determining the total number of vehicles that do not receive an emissions inspection. This is due to legitimate circumstances in which a vehicle is registered in a county requiring emissions testing and primarily operated in a non-emissions county and data entry issues in the vehicle registration and inspection databases. **Figure 5** shows the number of violations DPS issued for non-compliance with inspection renewal requirements from fiscal years 2006 to 2011. This figure does not include violations issued by local law enforcement entities. As a result, the total number of violations issued statewide is expected to be higher than the amounts shown in **Figure 5**.

Proof that a vehicle passed a safety inspection is not required for vehicle registration renewal. Data regarding vehicle safety inspections specifically is not transferred to DMV. However, the requirement for an annual safety inspection is applied inconsistently at the time of registration renewal. In counties requiring emissions testing, passage of an emissions inspections is required before a vehicle inspection is renewed. However, an inspection sticker is not provided until a vehicle has passed both a safety and emissions test. In these counties, data regarding vehicles for which inspection has not been renewed is transferred to DMV by DPS and TCEQ. DMV flags the vehicle's record and the owner cannot register the vehicle unless there is proof that the vehicle's inspection has been renewed. This process is shown in **Figure 6**.

Recommendation 4 would amend the Texas Transportation Code, Chapter 502, to require that a motor vehicle has successfully passed a safety inspection as a prerequisite for a vehicle's registration renewal, regardless of county attainment status. This requirement is consistent with the way the state enforces current vehicle emissions requirements. Laws requiring proof of financial responsibility are similarly

FIGURE 4
TEXAS COUNTIES REQUIRING MOTOR VEHICLE EMISSIONS TESTING, FISCAL YEAR 2012



SOURCE: Texas Department of Public Safety.

FIGURE 5
EXPIRED VEHICLE INSPECTION CITATIONS ISSUED BY DPS, FISCAL YEARS 2006 TO 2011

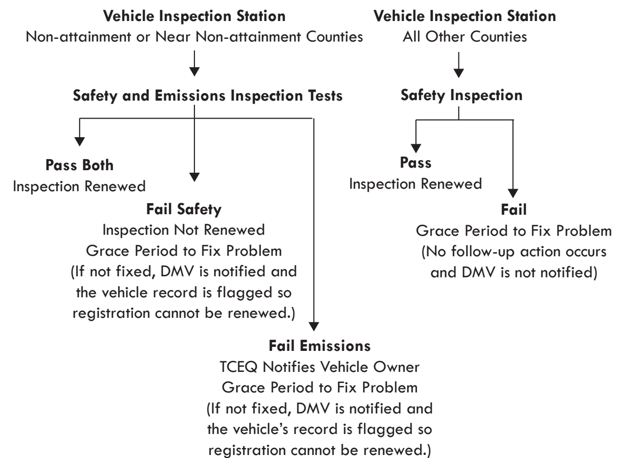
FISCAL YEAR	INSPECTION VIOLATIONS
2006	42,418
2007	43,746
2008	43,963
2009	44,584
2010	45,581
2011	48,977

SOURCE: Texas Department of Public Safety.

enforced at the time of registration through the TexasSure system. This matches personal auto insurance policies sold in Texas with registered vehicles in the state. All 254 county tax assessor-collectors use the database to determine if a vehicle is insured at the time of registration.

To enforce this requirement, DPS should send data regarding all safety inspections to DMV. This would ensure DMV

FIGURE 6
VEHICLE INSPECTION PROCESS, 2012–13 BIENNIUM



NOTE: TCEQ = Texas Commission on Environmental Quality; DMV = Texas Department of Motor Vehicles.
SOURCE: Legislative Budget Board.

receives accurate data and remove the burden from motorists to show proof of a safety inspection. DPS currently collects information regarding vehicle inspections. This data is being added to the Texas Law Enforcement Telecommunication System so that law enforcement entities can determine a vehicle's inspection status. DPS could include this information in files it already sends to DMV regarding vehicle emissions inspections.

If drivers operate vehicles with an expired inspection, they can only be penalized through a citation issued by law enforcement. No penalty is applied when the inspection is renewed. The expiration date given to motor vehicle inspections is always one year from the date an inspection occurs rather than the original expiration date. These policies inadvertently result in a financial incentive to operate a vehicle out of compliance and are inconsistent with laws regarding vehicle registration renewal. The lack of monetary penalties for late inspection renewals reduces the state's ability to verify a vehicle is safe and complies with emissions requirements. Each month a vehicle is driven with an expired inspection, its operator is paying less than required by law.

To increase consistency between vehicle registration and inspection renewal laws, Recommendation 5 would amend the Texas Transportation Code, Chapter 548, to prorate the expiration of late renewals so the expiration month will not change from the original inspection expiration date. Additionally, the recommendation would restructure the vehicle inspection renewal fee so it increases each month an inspection renewal is delinquent. These steps would reduce the number of vehicles operating out of compliance and prevent drivers from operating vehicles without paying the amount required by law to use the roads. Drivers would be incentivized to comply with motor vehicle inspection requirements because the financial penalty for non-compliance would apply to all motorists, not solely those cited by law enforcement for driving with an expired inspection.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendation 1 would require all persons claiming a valid reason for renewing a vehicle registration late to sign an affidavit as legal verification of the reason for which they are claiming and would have no significant fiscal impact.

Delinquency penalties for passenger vehicles are deposited with other registration fees and it is not possible to determine how much revenue the penalty generates annually. As a result, it is not possible to determine what amount of revenue Recommendations 2 and 3 would generate above what the state currently collects in delinquency penalties.

Recommendation 2 would apply the 20 percent delinquency penalty of $10.15 (based on the current registration fee of $50.75 for passenger vehicles) to all late registrants without a valid reason. Had the penalty been applied to all late registrations in fiscal year 2010, $19 million would have been deposited into the State Highway Fund. Based on a projection of late registrations, applying the 20 percent penalty to all late registrations would generate $34 million in revenue for the State Highway Fund during the 2014–15 biennium. The amounts above include revenue the state collects under current law for late registration penalties.

Recommendation 3, restructuring the current delinquency penalty by increasing it for each month a registration is late, would result in a revenue gain to the State Highway Fund. The amount of revenue gain would depend upon the structure of the prorated fee that would be implemented. In the example previously discussed, the delinquency penalty would increase for vehicle owners renewing their vehicle registration more than one month late. If both Recommendations 2 and 3 had been in place during fiscal year 2011, $35 million in revenue would have been generated for the State Highway Fund. This amount includes the revenue collected under current law for late registration penalties. Based on a projection of late registrations, it is expected the combined revenue generated from Recommendations 2 and 3 would be $57 million during the 2014–15 biennium, which includes revenue collected under current statutory provisions.

Vehicle registration fees are remitted to the Texas Department of Motor Vehicles and deposited into the State Highway Fund. Article VIII, Section 7-a, of the Texas Constitution requires net revenues from vehicle registration fees to be used solely for acquiring rights-of-way, constructing, maintaining, and policing public roadways, and the administration of traffic and safety laws on public roadways. Any increases in vehicle registration fees or collections would be subject to this provision.

Recommendation 4, which would require a vehicle to pass a safety inspection before renewing registration, is expected to increase the number of vehicles receiving annual safety inspections and therefore increase revenue to the Texas Mobility Fund, Clean Air Account, and Texas Emissions Reduction Plan Account. However, the revenue gain resulting from this recommendation cannot be estimated. To

implement this recommendation, DPS would need to include information regarding vehicle safety inspections along with information it already sends to DMV regarding vehicle emissions inspections. Since DPS already transmits this data to DMV for vehicles receiving emissions inspections, it is assumed the agencies could implement this with existing resources.

Recommendation 5, prorating motor vehicle inspection fees so they increase each month an inspection is late, would result in a revenue gain to the state as all persons not complying with motor vehicle inspection renewal requirements would now be penalized rather than only persons cited by law enforcement. The revenue gain from these recommendations cannot be estimated because the number of motorists in violation of these requirements and the number of months motor vehicle inspections are renewed late cannot be determined.

The annual safety inspection renewal fee is statutorily set at $12.50 for all passenger vehicles. The inspection station retains a portion of this fee and $5.50 is remitted to the state and deposited into the Texas Mobility Fund and the Clean Air Account in the General Revenue Fund. Additional fees are charged in certain counties in which vehicles are required to be emissions tested. These fees are set by DPS and the highest fee charged for an emissions inspection is $27.25. Revenue from this fee is used to cover the cost of providing inspections and a portion is remitted to the state for deposit into the Texas Mobility Fund, Clean Air Account, and Texas Emission Reduction Plan Account to pay for administration of the program. Article III, Section 49-k, of the Texas Constitution states that while money in the Texas Mobility Fund is pledged to the payment of outstanding bonds, any source of revenue dedicated to the fund may not be reduced, rescinded, or repealed unless it is replaced by the dedication of a different source of revenue projected to be of equal or greater value. These recommendations would not impact the current disbursement of revenue from motor vehicle inspection fees.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

EVALUATE THE BENEFITS OF AND LIMIT STATE HIGHWAY FUNDS FOR TRAVEL INFORMATION CENTER OPERATIONS

The Texas Department of Transportation operates 12 travel information centers. Each center has travel counselors who provide assistance with routings, points of interest, events, and road conditions. Maps, travel literature, restrooms, and drinking water are available for free at all centers. Additionally, most centers have picnic facilities, video theatres, interpretative displays, welcome to Texas photo areas, and walking trails. Similar to the safety rest area program, travel information centers also provide travelers a convenient place to stop and rest with the intention of reducing fatigue-related accidents.

Travel to and within Texas generates state and local taxes and supports travel-related jobs. According to the Texas Department of Transportation, travel information centers help promote travel. Despite the statewide benefits attributed to travel information centers, no comprehensive study quantifying the tax or safety benefits resulting from the centers has been done so it is not possible to determine the state's return on investment from operating the centers. The state has a dedicated source of funding for tourism activities, but the centers are funded entirely from the State Highway Fund.

Increases in the state's population, economy, vehicle miles traveled, and cost of road construction materials have reduced the ability of the State Highway Fund to pay for the state's transportation needs. Shifting costs for travel information center operations to an alternative revenue source would increase the amount of revenue available to the Texas Department of Transportation for transportation projects.

FACTS AND FINDINGS

- ♦ The number of visitors contacting travel counselors has declined by 42.7 percent over the past five fiscal years. This decline is consistent with previous trends in which there have been fluctuations in the number of visitor's using travel counselor services.
- ♦ The Governor's Office, Economic Development & Tourism Division, reported 208.3 million domestic travelers visited Texas destinations in 2011. According to the Texas Department of Transportation, approximately 2 million persons contacted travel counselors while at travel information centers, or 1.0 percent of the state's visitors.
- ♦ According to a Texas Department of Transportation survey, 39.8 percent of visitors using travel-counseling services at travel information centers indicated they would extend their stay because of information provided. Of these visitors, 24.7 percent extended their stay by one day, 22.5 percent extended their stay by two days, and 42.6 percent extended their stay by three days. Such extensions result in extra sales, hotel, and motor fuels tax for the state although the amount of additional revenue generated from these extended stays is unknown.
- ♦ The Texas Transportation Code authorizes use of the State Highway Fund to operate and maintain travel information centers. In fiscal year 2011, approximately $5.2 million in Other Funds (State Highway Fund) was spent to maintain and operate the centers.

CONCERNS

- ♦ Data regarding total visitors to travel information centers and use of the unique travel services they offer is incomplete. As a result, it is not possible to determine the cost effectiveness of travel information center operations.
- ♦ The number of travelers using services at travel information centers fluctuates and has declined since 2007. A small percentage of the state's total tourists use the travel services offered at the centers.
- ♦ The amount of State Highway Fund revenue generated by travel information centers is estimated to be less than what is needed to maintain and operate the centers. Travel information centers are considered a part of the state's overall efforts to encourage tourism but no sources of state funding dedicated to tourism contribute to their maintenance or operations.
- ♦ Alternative sources of revenue more closely aligned with state or local tourism promotion efforts, are not being used to offset the cost of travel information center operations. Using another source of revenue

to operate the centers would make additional state highway funds available for activities related to the state's transportation projects.

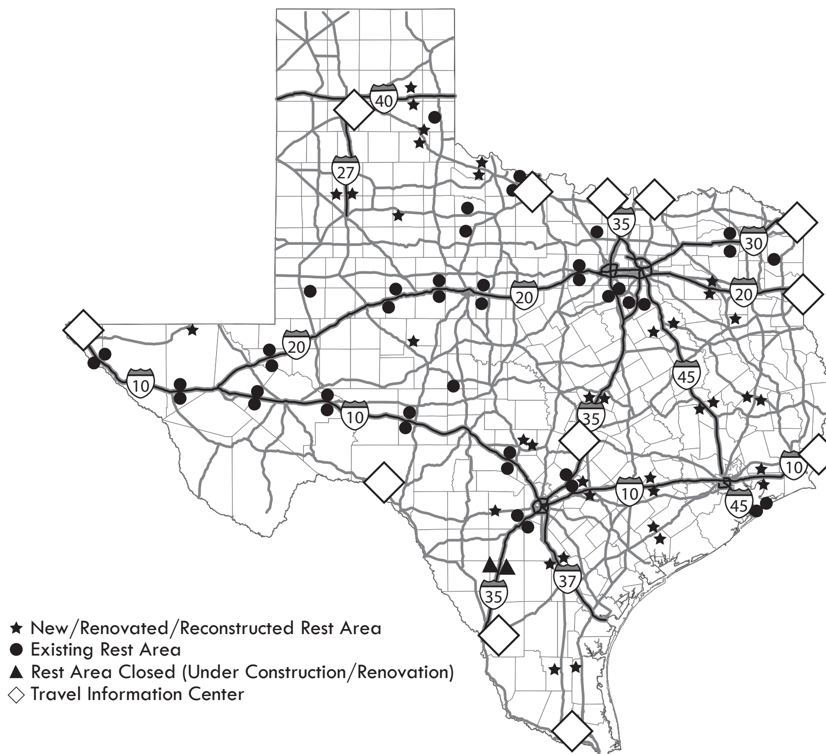
RECOMMENDATIONS

- **Recommendation 1:** Include a rider in the introduced 2014–15 General Appropriations Bill requiring the Texas Department of Transportation, with assistance from the Office of the Governor, Economic Development & Tourism Division, to develop a methodology to determine the economic and safety impact of travel information center activities and publish findings based on this methodology.
- **Recommendation 2:** Adopt one of the following options as an alternative method of funding the operations of travel information centers: (1) amend statute to authorize a portion of the revenue derived from collection of the hotel occupancy tax to be used for travel information center operations; (2) amend statute to set rates for commercial advertising and charges for other services available at travel information centers at a level that generates receipts sufficient to cover the cost of operating the centers; (3) amend statute to transfer travel information center operations to local governments; or (4) amend statute to transfer travel information center operations to a private entity.
- **Recommendation 3:** Include a contingency rider in the 2014–15 General Appropriations Bill replacing appropriations from the State Highway Fund to the Texas Department of Transportation for the operation of travel information centers, in an amount of $3.5 million per fiscal year, with one of the four methods of funding for travel information center operations implemented by Recommendation 2 and reducing the number of full time equivalents if applicable.

DISCUSSION

Texas' travel information center (TIC) program began in 1935 when the former Texas Highway Commission established "information houses" to serve travelers. By 1936, the state had 13 centers. Texas has 94 rest areas; 12 of which are classified as TICs. **Figure 1** shows the location of the state's rest areas and TICs.

FIGURE 1
TEXAS' REST AREAS AND TRAVEL INFORMATION CENTERS, FISCAL YEAR 2012



Source: Texas Department of Transportation.

Each TIC is staffed by travel counselors who provide information on routings, points of interest, events, and road conditions. Maps and travel literature are available at all centers. **Figure 2** provides further information regarding features available at each TIC.

Federal law requires states to have safety rest areas to encourage drivers to stop and rest during long trips. Federal law also authorizes information centers for the purpose of providing information to motorists regarding places of interest and other information as chosen by the state.

The Texas Transportation Code requires TxDOT to maintain and operate TICs at the principal gateways to the state and provide highway information, guidance, and descriptive material to assist the traveling public and stimulate travel within the state. Statute authorizes TxDOT to use the State Highway Fund to pay for the cost of materials and maintaining and operating TICs. According to TxDOT, TICs provide safety benefits and support the state's tourism efforts. Adequate data is not available to determine the return on investment the TICs bring to the state.

ROLE OF TRAVEL INFORMATION CENTERS IN THE STATE'S TOURISM EFFORTS

The Office of the Governor, Economic Development & Tourism Division (EDT); Texas Commission on the Arts (TCA); Texas Historical Commission (THC); Texas Parks and Wildlife Department (TPWD); and TxDOT are the state agencies with primary responsibility for promoting tourism in Texas. Combined, these five entities budgeted approximately $50.4 million for fiscal year 2012 to conduct tourism-related activities. This amount includes appropriations to TxDOT for the maintenance and operations of TICs. TIC expenditures accounted for 10.3 percent of the state's fiscal year 2012 appropriations to these agencies for tourism-related efforts.

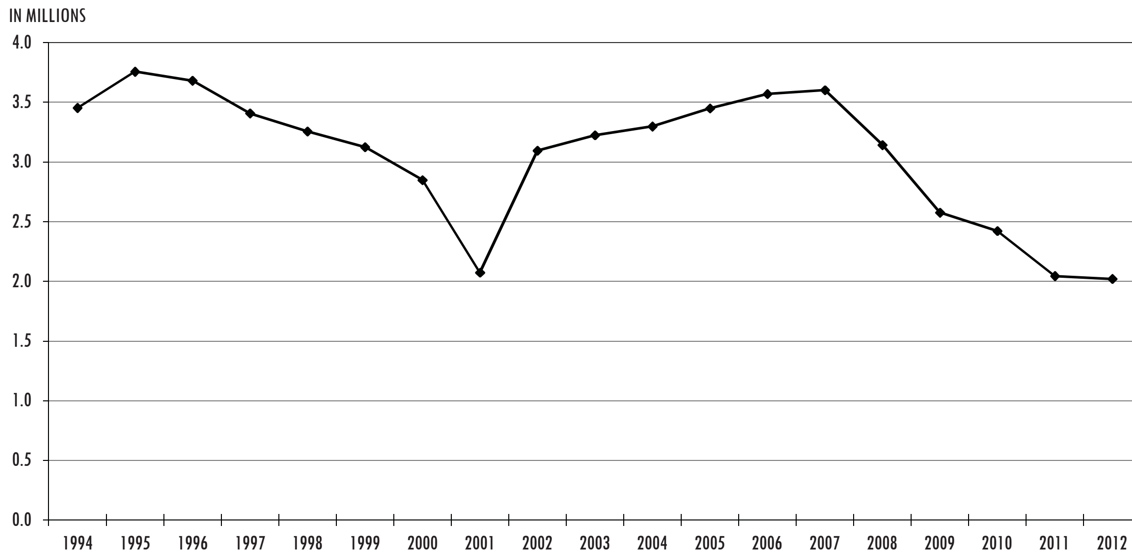
The number of TIC visitors having contact with a travel counselor is measured at all 12 TICs. These numbers fluctuate, as shown in **Figure 3**. Over the past five fiscal years, the number of visitors contacting a travel counselor has declined 42.7 percent. TxDOT attributes this decline primarily to the economic recession and a statewide decrease in travel. However, since the decline in visitors to TICs began in 2007, the number of overall domestic visitors to Texas has increased by more than 10 million. Additionally, today technology allows travelers to receive real-time traffic and road condition information en-route. Dynamic message signs display information as travelers proceed along highways; highway advisory radio disseminates traffic and road information, and TxDOT maintains a website travelers can use to view highway conditions. EDT, TCA, THC, and TPWD also maintain websites that provide travel information to Texas tourists. With the prevalence of mobile phones and phones with Internet browsing capabilities, this source of information is readily available to many highway travelers during their excursion.

FIGURE 2
SELECT FEATURES OF TEXAS' TRAVEL INFORMATION CENTERS, FISCAL YEAR 2012

LOCATION	RESTROOMS	DRINKING WATER	PICNIC FACILITY	VIDEO THEATRE	INTERPRETIVE DISPLAY	WELCOME TO TEXAS PHOTO AREA	WALKING TRAIL
Amarillo	X	X	X	X	X	X	
Anthony	X	X	X	X	X	X	
Austin (Capitol)	X	X			X		
Denison	X	X	X	X	X	X	
Gainesville	X	X	X	X	X	X	
Rio Grande Valley (Harlingen)	X	X	X	X	X	X	
Langtry	X	X		X	X		X
Laredo	X	X	X	X	X	X	
Orange	X	X	X	X	X	X	X
Texarkana	X	X	X	X		X	
Waskom	X	X	X	X	X	X	
Wichita Falls	X	X	X	X		X	

Source: Legislative Budget Board.

FIGURE 3
NUMBER OF TIC VISITORS HAVING CONTACT WITH A TRAVEL COUNSELOR, CALENDAR YEARS 1994 TO 2012



Source: Texas Department of Transportation.

TxDOT uses traffic counters to estimate the total number of TIC visitors, including those that do not interact with travel counselors. At the end of fiscal year 2012, 8 of 12 TICs had traffic counters and technical difficulties with some counters resulted in inaccurate counts. As a result of these factors, data regarding total visitors to TICs is incomplete. Based on the traffic counts captured in fiscal year 2012, approximately 1.6 million vehicles stopped at the Amarillo, Anthony, Denison, Gainesville, Laredo, Orange, Texarkana, and Waskom TICs. In August 2007, TxDOT estimated 7 million highway users visit TICs annually and 3.6 million, or 51.7 percent, of those visitors contact travel counselors.

EDT tracks the number of visitors to Texas. The number of visitors contacting travel counselors at TIC's has made up less than 2.0 percent of visitors to Texas destinations in each of the past five calendar years, as shown in **Figure 4**.

ECONOMIC AND SAFETY BENEFITS ASSOCIATED WITH TRAVEL INFORMATION CENTERS

EDT contracted with Dean Runyon Associates to conduct a study of the economic impact of travel on Texas from 1990 to 2011. According to this study, direct travel-related spending in Texas was $63.2 billion in calendar year 2011, which generated $3 billion in state tax revenue. This amount

FIGURE 4
PERSONS CONTACTING TRAVEL INFORMATION CENTER COUNSELORS AS A PERCENTAGE OF TOTAL TEXAS VISITORS, CALENDAR YEARS 2007 TO 2011

CALENDAR YEAR	DOMESTIC VISITORS TRAVELING TO TEXAS (IN MILLIONS)	TOTAL VISITOR CONTACTS WITH TRAVEL COUNSELORS (IN MILLIONS)	PERCENTAGE OF TOTAL VISITORS CONTACTING A TRAVEL COUNSELOR
2011	208.3	2.1	1.0%
2010	198.0	2.4	1.2%
2009	186.0	2.6	1.4%
2008	193.8	3.2	1.6%
2007	197.5	3.6	1.8%

Note: International visitors were note included because of difficulties in determining the total amount of international visitors to the state. However, the addition of international visitors would increase the total visitors to the state and decrease the percentage of total visitors contacting a travel counselor. Total contacts with travel counselors includes both persons visiting travel information centers and road condition calls answered by a travel counselor.
Source: Legislative Budget Board.

includes approximately $1.5 billion in sales tax, $694 million in state gasoline taxes, and $398 million in state hotel taxes.

The amount of tax revenue resulting from TICs alone has not been quantified. In 2007, Dye Management Group, Inc. conducted an audit of TxDOT's travel and tourism programs. The audit estimated TICs generate approximately $3.1 million per year in motor fuels taxes. No estimate of the state sales or hotel tax revenue generated as a result of TIC activities was provided.

The Texas Transportation Institute (TTI) and TxDOT have each studied the effect of information provided at TICs on visitor behavior. Both studies were limited in scope, covering less than one year and surveying less than 0.2 percent of TIC visitors contacting a travel counselor. Of 2011 TTI survey respondents who received travel counseling assistance at a TIC, 29.3 percent indicated they extended their stay because of information provided. Of responses to a 2012 TxDOT survey, 39.8 percent of the visitors said they would extend their stay in Texas as a result of information provided at TICs. Neither survey explored how much tax revenue the state gained as a result of these extended stays. TxDOT has been working to complete a more thorough survey of TIC visitors.

TICs provide drivers an opportunity to stop and rest. However, the accidents avoided as a result of stops at TICs has not been quantified. In 2011, TTI estimated safety benefits accrued by highway users at safety rest areas and TICs across three Texas corridors. The only TIC included in this study was the Amarillo Travel Information Center, which was closed briefly for renovations during the time studied. The study found there was a 9.0 percent reduction in casualties along this corridor after the Amarillo TIC reopened. However, the amount of this reduction specifically attributed to the TIC, independent of the impacts of rest stops or other roadway safety improvements, was not provided.

The Travel Information Division at TxDOT maintains a toll-free number. Travel counselors can be contacted via this number for travel information, road construction information, and weather-related problems on state highways. During an emergency, the public can call this number to obtain information on evacuation routes, road conditions, contra flow, and any other TxDOT assistance available.

The economic and safety benefits of services provided at TICs have only been quantified on an ad hoc basis. No studies completed to date have evaluated the TIC program as a whole or consistently monitored the benefits attributed to TICs. As a result, it is not possible to verify or determine to what extent TICs contribute to road safety or the state's economy. Therefore, the state cannot identify the return on investment resulting from the cost of operating TICs. Recommendation 1 would include a rider in the introduced 2014–15 General Appropriations Bill to direct TxDOT to work with EDT to develop a methodology to determine the economic and safety impact of TIC activities. The recommendation would also direct TxDOT to report findings based on this methodology on its website no later than November 2014. This information would provide policy makers with information necessary to determine the effectiveness of TICs.

TxDOT and EDT already work together to measure the return on investment of tourism marketing activities undertaken by TxDOT through a memorandum of understanding required by the Texas Government Code. Statute also requires EDT to annually develop a strategic tourism plan to increase travel within the state that provides the most effective and efficient expenditure of state funds for in-state marketing and establishes performance measures, including the return on investment, for the tourism-related efforts of all state agencies. However, the current strategic plan limits the measurement of TICs to the number of customers served and does not include any information relating to the return on investment.

COST OF TRAVEL INFORMATION CENTER MAINTENANCE AND OPERATIONS

Funding for the state's TICs is appropriated to TxDOT from the State Highway Fund. TxDOT's Travel Information strategy, which includes TIC funding, received $17.1 million per fiscal year in the 2012–13 biennium from the State Highway Fund. The Texas Transportation Code authorizes use of the State Highway Fund to pay for TIC maintenance and operations. Approximately $5.2 million of TxDOT's Travel Information appropriation was used to pay for TIC operations and maintenance in fiscal year 2011. The majority of these funds, approximately $3.2 million, are expended on items directly related to operations. This includes items such as salaries and wages, consumable supplies, and uniforms.

All but one of the TICs are located on state-owned right-of-way that TxDOT is responsible for maintaining. TxDOT's Maintenance Division and district offices provide engineering and architectural expertise as well as assistance with

purchasing, supplies, accounting, and general maintenance for TICs. The one exception is the TIC at the State Capitol. This center is located in the General Land Office and maintained by the State Preservation Board (SPB).

TIC operating costs are primarily related to promoting the state's attractions and businesses to the traveling public through travel counselors and other means, which is a function of economic development and tourism. Traditional sources of highway funding have not been enough to sustain the state's highway system to the level desired. As a result, the Texas Legislature has made new financing tools, including bond proceeds and comprehensive development agreements for certain projects, available to TxDOT. The Texas Legislature has recently reduced the use of State Highway Funds for tourism promotion. The Eighty-second Legislature, Regular Session, 2011, discontinued use of an interagency contract in which State Highway Funds were used for cultural tourism grants and marketing of arts and cultural tourism events at the Texas Commission on the Arts. Funding TIC operations with alternative sources of revenue more closely aligned with state or local tourism efforts would make additional State Highway Fund revenues available for activities directly related to the state's transportation system.

Recommendation 2 would amend statute to implement one of four options for the use of alternative sources of revenue to fund travel information center operations. Each option would fund the cost of TIC operations by generating revenue or with a source other than the State Highway Fund that is more closely aligned with tourism efforts. With all of these options, TxDOT would continue to pay for the maintenance of TICs located on state-owned right-of-way. This is because one function of TICs is to provide a safe rest area and TxDOT is responsible for maintaining the right-of-way on which most TICs are located.

USE HOTEL TAX REVENUE TO FUND TRAVEL INFORMATION CENTER OPERATIONS

The first option under Recommendation 2 would amend the Texas Tax Code, Section 156.251(d), to authorize a portion of the revenue derived from collection of the hotel occupancy tax for the Economic Development and Tourism office to be used for operation of the state's TICs.

The state's primary source of revenue for funding tourism operations is General Revenue from a portion of the Hotel Occupancy Tax. This tax is levied on each person who pays for the use or possession of a room or space in a hotel costing more than $15 a day. Statute allocates 0.5 percent of the collection of the Hotel Occupancy Tax to advertising and other marketing activities of EDT. During each of the past five fiscal years, collections in excess of appropriations from the Hotel Occupancy Tax revenue set aside for tourism promotion were more than what was spent on TIC operations, as shown in **Figure 5**.

At least seven other states place partial or full responsibility for TIC or welcome center operations with the entity responsible for the state's tourism efforts. In Texas, this responsibility is assigned to EDT. Alabama, Arizona, Arkansas, Colorado, Connecticut, and Louisiana all operate TICs through state tourism entities. Maryland splits the cost of operating its travel information centers between the Department of Transportation and the Department of Business and Economic Development. Welcome Centers in West Virginia are under the Department of Transportation but staffed by the Division of Tourism of the state's Department of Commerce.

GENERATE REVENUE FROM ACTIVITIES AT TRAVEL INFORMATION CENTERS

The second option to implement Recommendation 2 would amend Texas Transportation Code, Chapter 204, to require TxDOT to set rates for commercial advertising and charges for other services available at TICs at a level that generates

FIGURE 5
REVENUES, APPROPRIATIONS, EXPENDITURES, AND BALANCES OF GENERAL REVENUE FUND HOTEL OCCUPANCY TAX FOR ECONOMIC DEVELOPMENT ACCOUNT, FISCAL YEARS 2008 TO 2012

(IN MILLIONS)	2012	2011	2010	2009	2008
Revenue	$62.3	$39.4	$33.1	$41.4	$56.3
Appropriations	$16.8	$32.0	$30.3	$52.6	$27.5
Expenditures	$58.6	$35.0	$35.0	$48.9	$63.0
Balance	$16.0	$12.2	$7.8	$9.7	$17.3

SOURCE: Legislative Budget Board.

enough revenue to cover TIC operating costs. This revenue would be deposited to the State Highway Fund; however, it should be deposited into a subaccount used solely for funding TIC operations.

Using this revenue to fund TIC operations would be consistent with the way other travel-related functions carried out by TxDOT are funded. The Texas Travel Division produces a number of travel publications; primarily the *Texas State Travel Guide, Texas Accommodations Guide, Texas Official Travel Map, Texas Events Calendar*, and *Texas Highways*. In fiscal year 2011, the estimated cost to produce these publications was $6.5 million in State Highway Funds. Of this amount, $5.2 million was paid for by revenues generated through the sale of publications; so the net cost to the state was $1.3 million. The Texas Transportation Code requires TxDOT to set subscription rates and other charges for *Texas Highways* that generate the approximate amount of revenue needed to produce and distribute the magazine. The Texas Transportation Code also requires TxDOT to provide a single map for free; however, a charge is authorized for large quantities.

The federal transportation authorization bill, Moving Ahead for Progress in the 21st Century (MAP-21) was signed into law in July 2012. This legislation expanded the types of allowable commercial activities at rest areas. These activities now include:

- commercial advertising and media displays if they are exhibited solely within a facility constructed in the rest area and illegible from the main traveled way;
- the sale of books, DVDs, and other media to promote tourism;
- the sale of tickets for events or attractions that are of a historical or tourism-related nature;
- the sale of travel-related information including maps, travel booklets, and hotel coupon booklets; and
- the operation of lottery machines if priority is afforded to certain blind vendors.

The Texas Transportation Code authorizes TxDOT to sell items that promote and advertise Texas such as calendars, books, prints, caps, clothing, and other items approved by the Texas Transportation Commission. Statute requires revenue from these sales be deposited to the State Highway Fund for use in travel and information operations. Other potential sources of revenue include:

- charging a fee for Wi-Fi service; this could be limited to use of sites not related to travel or use exceeding a specific period as has been done in other states;
- sponsored electronic displays and kiosks that display information about traffic, weather, road construction, tourist information, and/or road safety similar to kiosks currently in place in other states; and
- charging a fee for restaurants, hotels, and other private businesses that currently benefit from the dissemination of materials promoting their businesses at TICs without paying for this service.

AUTHORIZE LOCAL GOVERNMENT ENTITIES TO OPERATE TRAVEL CENTERS

The third option under Recommendation 2 would amend Texas Transportation Code, Chapter 204, to prohibit TxDOT from operating travel information centers and authorize local governments to operate the centers instead. If a local government chose not to operate a travel information center, TxDOT could continue to manage it as one of the state's unmanned rest areas.

The Texas Municipal League has 1,121 member cities. Only 12 of these cities, or 1.0 percent, directly benefit from having state maintained, operated, and funded TICs in their boundaries. Many municipalities operate their own tourist information office. The Texas Association of Convention and Visitors Bureaus has 170 member municipalities. Some of these municipalities operate convention and visitor bureaus, others operate chambers of commerce, and others maintain city travel or tourism departments. Of the 12 municipalities in which TICs are located, 10 operate their own convention and visitors bureaus or chamber of commerce. Each region in which a TIC is located has multiple municipalities that operate convention and visitor bureaus and chambers of commerce. These municipalities are shown in **Figure 6**.

According to the Texas Travel Industry Association (TTIA), the travel industry and cities across the state benefit from promotional brochures and advertising distributed through the 12 TICs operated by the state. TTIA noted travel centers operated by local communities may not provide the same level of promotion and advertising to attractions and cities outside of their region. Communities without TICs may attract visitors as a result of information made available through the centers. This finding was also reported by TxDOT, which stated TICs

FIGURE 6
LOCATIONS OF TEXAS TRAVEL INFORMATION CENTERS, CONVENTION AND VISITORS BUREAUS, AND CHAMBERS OF COMMERCE, AUGUST 2012

REGION*	TRAVEL INFORMATION CENTER LOCATION	CONVENTION AND VISITORS BUREAU LOCATIONS	CHAMBER OF COMMERCE LOCATIONS
Panhandle Plains	Amarillo and Wichita Falls	Abilene, Amarillo, Andrews, Big Spring, Lubbock, San Angelo, Wichita Falls	Andrews, Brownwood, Plainview, Sweetwater, Vernon
Big Bend Country	Anthony and Langtry	Anthony, El Paso, Midland, Odessa, Pecos	Brownfield, Del Rio, Pecos
Hill Country	Austin (Capitol)	Austin, Bandera, Boerne, Fredericksburg, Georgetown, Kerrville, Round Rock, San Marcos, Uvalde	Blanco, Brady, Canyon Lake, Cedar Park, Kyle, Lake Travis, Lampasas, New Braunfels, Sonora, Taylor, Uvalde
Prairies and Lakes	Denison and Gainesville	Arlington, Brenham, Bryan-College Station, Canton, Corsicana, Dallas, Denison, Denton, Duncanville, Ennis, Farmers Branch, Fort Worth, Forest Hill, Frisco, Glen Rose, Gonzales, Graham, Granbury, Grand Prairie, Grapevine, Greenville, Hamilton, Hillsboro, Irving, Killeen, Lewisville, McKinney, Mesquite, Palestine, Plano, Richardson, Seguin, Sherman, The Colony, Waco, Waxahachie, Weatherford	Balch Springs, Bellmead, Belton, Cedar Creek, Cleburne, Clifton, Copperas Cove, Decatur, Denison, DeSoto, Gainesville, Greenville, Hamilton, Hillsboro, Historic Red River Country, Mineral Wells, Paris, Rockwall, Stephenville, Terrell, Weatherford
Gulf Coast	Harlingen (Rio Grande Valley) and Orange	Alvin, Baytown, Beaumont, Brazosport, Brownsville, Clute, Corpus Christi, Fort Bend County, Galveston Island, Harlingen, Houston, Kingsville, League City, Matagorda County, Nederland, Orange, Pearland, Port Aransas, Port Arthur, Rosenberg, Sealy, South Padre Island, Victoria	Angleton, Aransas Pass, Bee County, League City, Nederland, Port Lavaca, Rockport-Fulton, Weslaco, Wharton
South Texas Plains	Laredo	Balcones Heights, Laredo, McAllen, San Antonio	Eagle Pass, Edinburg
Piney Woods	Texarkana and Wichita Falls	Center, Cleveland, Conroe, Huntsville, Longview, Lufkin, Marshall, Nacogdoches, Shenandoah, Texarkana, The Woodlands, Tyler	Henderson, Kilgore, Mount Pleasant, New Boston, Texarkana

*As defined by the Texas Association of Convention and Visitors Bureaus.
Sources: Texas Department of Transportation; Texas Association of Convention and Visitors Bureaus.

> "…enable the smallest entities, rural communities, local museums, attractions, accommodations, and restaurants the opportunity to display their brochures, promote themselves, and sell their product alongside conglomerates and businesses with massive advertising budgets. All entities receive equal treatment and coverage, and highway users get unbiased input."

It is not possible to determine how much tourist spending results from TICs in individual local communities or at each of the state's attractions. Cities have several options for funding these centers. In addition to funding them with local tax revenues or through their chamber of commerce, this option would authorize a municipality to privatize the center or sell merchandise. Cities could also consider using volunteers, rather than paid staff, to serve as travel counselors as is the model in Colorado.

Other states use community-owned TICs. Arizona operates one state-owned TIC, but the state has more than 50 local visitor information centers. Kansas operates two TICs and has 16 community-owned centers. In North Carolina, nine welcome centers are maintained by the Department of Commerce and 12 visitor centers are maintained by local entities. Eight of these visitor centers are located at North Carolina Department of Transportation rest areas, one is on the state's right-of-way, and three are not on the state's right-of-way. Maryland maintains land and facilities where welcome centers are operated, but two county governments provide operating funds and staff for welcome centers. The California Travel and Tourism Commission oversees the state's welcome centers, but they may be operated by convention centers, visitor bureaus, chambers of commerce, local governments, federal governments, and private entities.

The California Travel and Tourism Commission can collect fees from any entity operating a welcome center to cover the state's cost of administering the centers.

PRIVATIZE OPERATIONS OF TRAVEL INFORMATION CENTERS

The last option to implement Recommendation 2 would amend Texas Transportation Code, Chapter 204, to require TxDOT to lease the operation of travel information centers to a private entity upon approval from the Federal Highway Administration's (FHWA) Regional Administrator. This option would prohibit TxDOT from taking any action that would result in a loss of federal highway funding for the state or would increase the state's expenditures for TICs. It is assumed it would take time to acquire FHWA approval and to contract with a vendor to implement this option so no changes would occur in fiscal year 2014.

Federal law authorizes states to lease the construction and operation of information facilities. For an information center to be privately operated, it must be approved by the FHWA's Regional Administrator, in no way violate control of access or adversely impact traffic in the main traveled way, and the agreement between the state and private operator must provide that:

- the state will have the title to the information center upon completion of construction or lease termination;
- advertising will be limited to matters relating to and of interest to the traveling public;
- equal access will be provided at reasonable rates to all advertisers considered qualified by the state;
- forty percent or more of all display areas and audible communications will be devoted free of charge to providing information to the public and public service announcements; and
- no charge will be made to the public for goods or services except for telephone and articles dispensed by vending machines.

Other states have successfully privatized operation of their TICs. All five of Florida's official welcome centers are operated by a private entity, Visit Florida. Georgia began privatizing operations of its 17 rest areas and 9 welcome centers in 2011 to recover maintenance costs. Virginia awarded a contract for operating vending kiosks and the sale of advertising rights at 42 rest areas and welcome centers that is expected to bring in $2 million per year. Two of North Carolina's locally operated visitor centers are operated by a private contractor. The North Carolina Departments of Commerce and Transportation are currently working together to privatize the state's welcome centers. South Carolina subcontracted several welcome centers to non-profit concessionaries.

In 2012, the Maryland General Assembly passed legislation that requires the State Highway Administration to initiate a process to privatize the operation and maintenance of the state's rest areas and welcome centers. Minnesota statute authorizes its Transportation Commission to enter into lease agreements with private entities to operate safety rest areas and travel information centers. Arizona, California, Oregon, and Washington are also considering reforms that would allow, at a minimum, advertising at rest areas and welcome centers.

Recommendation 3 would include a contingency rider in the 2014–15 General Appropriations Bill, reducing the appropriation to TxDOT for travel information center operations and in its place using one of the four methods of funding implemented by Recommendation 2. This rider would also reduce TxDOT's full-time-equivalent positions depending upon the method of funding implemented.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendation 1, directing TxDOT and EDT to develop a methodology and report on the economic and safety impact of TICs, could be completed using existing resources. These entities are already required to develop performance measures relating to the state's tourism operations and report on the investment gained as a result of expenditures on tourism promotion.

Recommendation 2 has four options for freeing up Other Funds (State Highway Fund) by changing the way in which TIC operations are funded. Shifting the cost of TIC operations from TxDOT to another entity would save between $3.5 million and $6.9 million in Other Funds (State Highway Fund) for the 2014–15 biennium. This savings could be used by TxDOT for other transportation related purposes. Alternatively, generating revenue through activities at TICs would also free up Other Funds (State Highway Fund) for other transportation related purposes. All the options in Recommendation 2 assume TxDOT would continue to spend $1.8 million in Other Funds (State Highway Fund) per fiscal year on maintenance for the centers. This would include expenditures for items such as utilities, security, and roadway materials at the TICs.

The first option, using hotel occupancy tax revenues, would result in a savings of $6.9 million in Other Funds (State Highway Fund) for the 2014–15 biennium and a cost of $6.9 million in General Revenue Funds (Hotel Occupancy Tax for Economic Development Account), as shown in **Figure 7**.

The fiscal impact of option 2, generating revenue at TICs, cannot be estimated at this time. The amount of revenue generated would depend upon the retail activities at the TICs, structure of any programs charging for literature display, and changes made to current operations such as the cost of offering Internet service. This revenue would continue to be deposited to the State Highway Fund as statute currently requires; however, it would be deposited into a sub-account for funding TIC operations.

The third option for Recommendation 2 is to turn TIC operations over to local governments. **Figure 8** shows this would result in a savings of $6.9 million in Other Funds (State Highway Fund) for the 2014–15 biennium. The cost of operating the TICs would instead be borne by local governments. These costs would be spread across the 12 municipalities in which TICs are located. It is assumed that the cost to local governments for the operation of the TICs would be the same, although local governments would have the ability to operate them differently, which could reduce operational costs. The current cost to operate each center ranges between $216,000 and $423,000 per fiscal year, depending upon the center.

The fourth option to implement Recommendation 2 is to privatize TIC operations. This would result in a savings of $3.5 million in Other Funds (State Highway Fund) for fiscal year 2015 and a reduction of 58 full-time equivalents, assuming the recommendation takes effect by August 31, 2014, as shown in **Figure 9**. Depending upon how a contract for privatizing operations is structured, a revenue gain to the State Highway Fund could result from this option.

The fiscal impact of Recommendation 3, including a contingency rider in the 2014–15 General Appropriations Bill replacing State Highway Fund appropriations to TxDOT for travel information center operations, would depend on which option the Legislature chooses as an alternative under Recommendation 2.

The introduced 2014–15 General Appropriations Bill includes a rider to implement Recommendation 1.

FIGURE 7
FIVE-YEAR FISCAL IMPACT OF OPTION 1, HOTEL OCCUPANCY TAX, FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE NET SAVINGS/(COST) IN OTHER FUNDS, STATE HIGHWAY FUND	PROBABLE NET SAVINGS/(COST) IN GENERAL REVENUE FUNDS, HOTEL OCCUPANCY TAX FOR ECONOMIC DEVELOPMENT
2014	$3,455,912	($3,455,912)
2015	$3,455,912	($3,455,912)
2016	$3,455,912	($3,455,912)
2017	$3,455,912	($3,455,912)
2018	$3,455,912	($3,455,912)

Source: Legislative Budget Board.

FIGURE 8
FIVE-YEAR FISCAL IMPACT OF OPTION 3, TURN OPERATIONS OVER TO LOCAL GOVERNMENTS, FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE NET SAVINGS/(COST) IN OTHER FUNDS, STATE HIGHWAY FUNDS	PROBABLE NET GAIN/(LOSS) IN FULL-TIME-EQUIVALENTS	PROBABLE NET SAVINGS/(COST) TO LOCAL GOVERNMENTS
2014	$3,455,912	(58)	($3,455,912)
2015	$3,455,912	(58)	($3,455,912)
2016	$3,455,912	(58)	($3,455,912)
2017	$3,455,912	(58)	($3,455,912)
2018	$3,455,912	(58)	($3,455,912)

Source: Legislative Budget Board.

FIGURE 9
FIVE-YEAR FISCAL IMPACT OF OPTION 4, PRIVATIZE TRAVEL INFORMATION CENTER OPERATIONS, FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE NET SAVINGS/(COST) IN OTHER FUNDS, STATE HIGHWAY FUND	PROBABLE NET GAIN/LOSS IN FULL-TIME-EQUIVALENTS
2014	$0	0
2015	$3,455,912	(58)
2016	$3,455,912	(58)
2017	$3,455,912	(58)
2018	$3,455,912	(58)

Source: Legislative Budget Board.

OVERVIEW OF TEXAS SEAPORTS

According to the Port Authority Advisory Committee, Texas has 11 deep draft public seaports, more than 9 shallow draft public seaports, and numerous private seaport facilities. Seaports are a significant part of Texas' and the nation's transportation system and economy. Approximately one of five vessels over 10,000 dead weight tons calling on U.S. ports stop at Texas' seaports. Many Texas seaports rank in the top 10 of all U.S. ports for vessel calls as well as tonnage. In 2010, Texas seaports handled exports valued at $206.6 billion. Seaports are points of convergence for much of the state's surface transportation system. The state's involvement in seaports is limited. Seaports vary in their governance, funding, and operations, but all seaports play an important role in both the Texas and national economies.

FACTS AND FINDINGS

- Texas is ranked second in U.S. waterborne commerce; the state's seaports handle approximately 500 million tons of foreign and domestic cargo. Cargo going through Texas seaports accounts for 19 percent of all U.S. port tonnage.
- Texas seaports generate approximately $65 billion in annual economic activity, accounting for 17 percent of the gross state product. Their activities generate approximately $5 billion in local and state tax revenues, 1 million jobs, and $48 billion in personal income.
- Public seaports are governed by port authorities, which have been individually established in statute. Seaports respond to the needs of the local area they serve. As a result, there are a variety of seaport operating structures and relationships between local and state governments and port authorities.
- Operations at Texas' public seaports are primarily funded from operating and usage fees, local tax revenues, and bond revenues. Channel maintenance is funded by the federal government. Some sources of federal and state funding may be used for security, environmental, and transportation projects.

DISCUSSION

A seaport is the point at which coastal transportation and land transportation systems meet. Seaports are surrounded by a harbor and have one or more docks for moving goods and people via ships. Harbors include improved navigation channels with underwater clearance for ships to maneuver.

According to the Port Authority Advisory Committee, Texas has more than 270 miles of deep draft channels and 11 deep draft public seaports. Another 750 miles of shallow draft channels and more than 9 shallow draft public seaports are also located in the state. In total, Texas has more than 970 public and private wharves, piers, and docks. In general, deep draft channels serve large commercial seagoing ships, freights, Navy warships, and Army preposition ships. Shallow draft channels generally serve smaller pleasure craft and fishing boats.

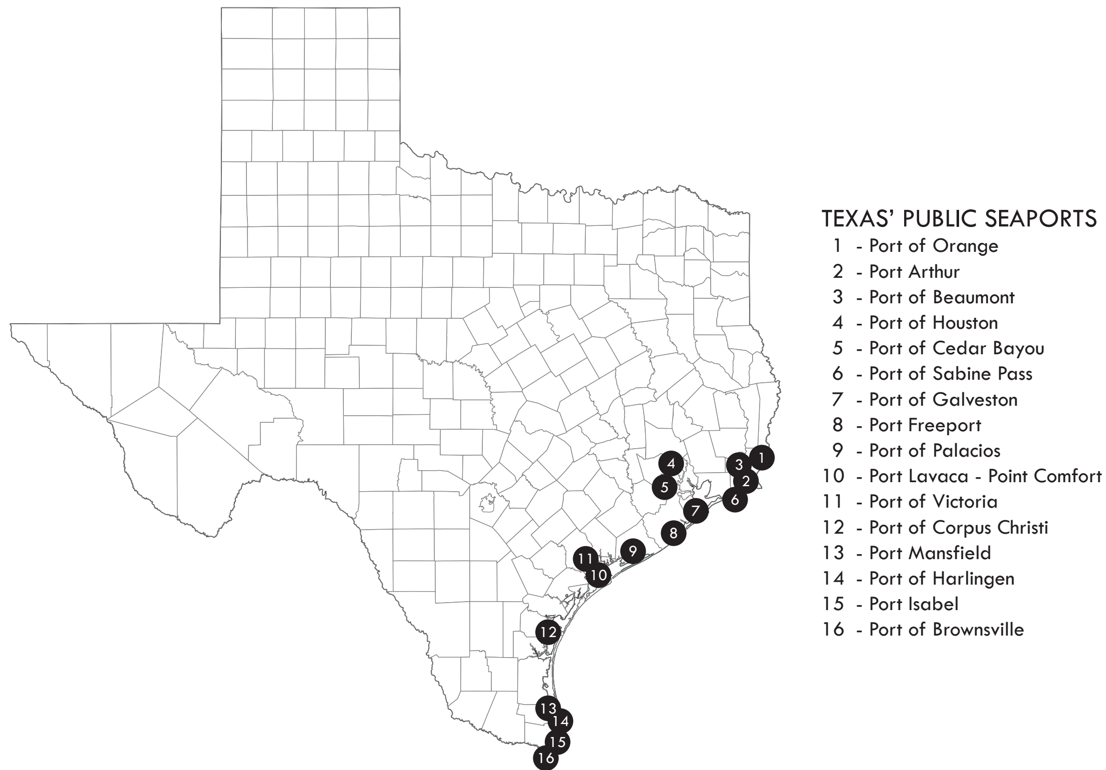
Waterborne trade plays a significant role in Texas' economy and is an important part of the state's overall transportation system. This report focuses on operations and economic impact of the state's public seaports, particularly the 16 that provided profiles for the 2011–2012 Port Capital Improvement Program. **Figure 1** shows the location of these ports. Some are located in major urban areas while others are more rural. Some seaports control all operations of their seaport while others include privately owned terminals or lease terminal operations to private entities. The size and types of cargo at the seaports differs as well. Some seaports handle a multitude of cargo types while others specialize in one or two. Some of the seaports transport cargo via rail or truck across the country while others primarily serve Texas.

THE ROLE OF SEAPORTS IN THE U.S. AND TEXAS ECONOMY

Texas seaports are a major contributor to trade for both the state and the country. Goods going through the state's seaports originate in more than 30 countries, and serve Texas, the U.S., and parts of Mexico and Canada. Each seaport's primary service area and trading partners is shown in **Figure 2**.

According to the U.S. Bureau of Transportation Statistics, Texas has seven of the top 50 U.S. ports in terms of tonnage and more products and goods are shipped in and out of Texas than from any other state. Texas had more waterborne

FIGURE 1
TEXAS' PUBLIC SEAPORTS, 2012



Source: Port Authority Advisory Committee.

FIGURE 2
CHARACTERISTICS OF TEXAS SEAPORTS, FISCAL YEAR 2011

SEAPORT (COMMON NAME)	CHANNEL DEPTH	SERVICE AREA	PRINCIPAL TRADING PARTNERS
Port of Beaumont	40 feet	Midwest and Western United States, Texas, Mexico, Canada	Brazil, Canada, Iraq, Russia, China, Chile, Peru, Norway, Nigeria
Port of Brownsville	42 feet	Mexico, Central and South America, United States	Mexico, Central/South America, China, Korea, Japan, Germany, Belgium
Cedar Bayou Navigation District	10 feet	Chambers County, Harris County	None
Port of Corpus Christi	45 feet	Texas, Central, Eastern and Western United States, Canada, Mexico	Venezuela, Nigeria, Mexico, Saudi Arabia, Columbia, Algeria, Kuwait, United Kingdom, Denmark, Australia, New Zealand, Cuba
Port Freeport	45 feet	Houston, Brazoria County, Texas, Midwest, Central, and Southwest United States, Canada, Mexico	Nigeria, Saudi Arabia, South Africa, Brazil, Columbia, Dominican Republic, Guatemala, Honduras, Mexico, Spain, Venezuela, India, China, Costa Rica
Port of Galveston	45 feet	Galveston, Galveston County, Harris County, Fort Bend County, Brazoria County, Chambers County, Texas and surrounding states, Midwest	Mexico, Guatemala, Costa Rica, Panama, Columbia, Venezuela, Brazil, Dominican Republic, Spain, Italy, Egypt, Israel, Turkey, Bulgaria, Belgium, United Kingdom, Germany, Saudi Arabia, United Arab Emirates, Kuwait, Iraq, Singapore, China, Japan, South Korea, Australia, Cuba
Port of Harlingen	12 feet	South Texas and Northern Mexico	Mexico

FIGURE 2 (CONTINUED)
CHARACTERISTICS OF TEXAS SEAPORTS, FISCAL YEAR 2011

SEAPORT (COMMON NAME)	CHANNEL DEPTH	SERVICE AREA	PRINCIPAL TRADING PARTNERS
Port of Houston (Houston Ship Channel)	45 feet	Houston, Harris County, Texas, Central, Midwest, Western U.S., Canada, Mexico	Mexico, Venezuela, Saudi Arabia, Germany, Brazil, China, Belgium, Algeria, Netherlands
Port of Port Isabel	36 feet	Rio Grande Valley of Texas	Honduras, El Salvador, Guatemala, Belize
Port of Mansfield	18 feet	Raymondville, Willacy County, South Texas	Mexico
Port of Port Lavaca – Point Comfort	36 feet	Mid-Texas Coastal Region and Southwest United States	Mexico, South America, Caribbean, Taiwan
Port of Orange	30 feet	Serves the maritime businesses requiring transmodal, docking, repair/new construction, or storage facilities.	None
Port of Palacios	14 feet	Safe harbor for commercial fishermen from Matagorda, Jackson, and Calhoun counties as well as other Texas and Gulf Coast ports	Commercial fishermen from ports in other states and around the Gulf of Mexico use the port
Port of Port Arthur	40 feet	Rail and truck service to all points within the United States, Canada, and Mexico. Barge service to Gulf Intracoastal Waterway, Mississippi, Illinois, Ohio, and Tennessee river systems	Mexico, Central and South America, United Kingdom, European continent, Sweden, Norway, and the Mediterranean Sea area
Port of Sabine Pass	42 feet	Sabine Pass, Jefferson County, Southeast Texas	None
Port of Victoria	12 feet	Gulf Intracoastal Waterway and entire U.S. Inland Waterway System	Regional

SOURCE: Legislative Budget Board.

tonnage than any other state in 2010, as shown in **Figure 3**. In 2008, the Comptroller of Public Accounts (CPA) estimated Texas seaports generated $9 billion in federal import tax revenues.

In calendar year 2010, cargo going through Texas seaports accounted for 19 percent of all U.S. port tonnage. The total tonnage of cargo going through Texas' largest cargo seaports is shown in **Figure 4.**

According to the Florida Department of Transportation (FDOT), most states saw either losses or relatively little growth in waterborne tonnage from 2004 to 2009. During this period, a decline in total waterborne tonnage occurred in Texas, but the state continued to be one of the leaders in total waterborne tonnage. The states growth in containerized cargo has been particularly strong. FDOT attributed this to the development of new terminal facilities at Texas seaports, access to expanding inland markets, accommodation for port-related manufacturing and warehouse/distribution

FIGURE 3
TOP 10 STATES BY WATERBORNE TONNAGE, CALENDAR YEAR 2010

STATE	TOTAL WATERBORNE TONNAGE (IN 1,000 TONS)
Texas	486,658
Louisiana	483,050
California	212,285
New Jersey	155,130
Washington	112,314
Illinois	108,083
Florida	101,455
Ohio	98,986
Kentucky	91,357
Pennsylvania	90,376

NOTE: In units of 1,000 tons.
SOURCE: U.S. Army Corps of Engineers.

FIGURE 4
TOTAL TONNAGE AT TEXAS SEAPORTS, CALENDAR YEAR 2010

SEAPORT NAME	TOTAL TONNAGE	U.S. RANK
Houston	227,133,231	2
Beaumont	76,958,592	4
Corpus Christi	73,663,432	6
Texas City	56,590,856	10
Port Arthur	30,231,786	25
Freeport	26,675,842	27
Galveston	13,948,896	41
Matagorda/Port Lavaca/ Port Comfort	8,879,191	54
Brownsville	4,616,492	78
Victoria	2,792,180	89

Source: U.S. Army Corps of Engineers.

centers, and increasing trade with Asia. **Figure 5** shows the types and amounts of cargos shipped from Texas seaports.

According to CPA, the transportation of goods from Texas seaports generates approximately $65 billion in annual economic activity. This activity accounts for 10 percent of the gross state product. The Texas Ports Association states ports bring in approximately $5 billion in local and state tax revenues, 1 million Texas jobs, and more than $48 billion in personal income.

According to the Texas Ports Association, the maritime industry provides more than $135 billion in economic value to the Texas economy. The entire state is impacted in some form by seaport activities. Exports from Texas seaports include agricultural products grown in the state. For instance, the Port of Harlingen exports all of the sugar produced in the Rio Grande Valley. Petrochemical products and industrial and agricultural machinery are imported and exported through the state's seaports. Retail goods and foreign manufactured automobiles arrive at Texas seaports and are then distributed across Texas and other states. **Figure 6** shows the principal cargo for each Texas seaport.

SEAPORT GOVERNANCE

Texas' public seaports have been established through the state legislative process. Both the statute governing each seaport

FIGURE 5
CARGO SHIPPED BY ALL TRAFFIC DIRECTIONS AT TEXAS SEAPORTS (IN SHORT TONS), CALENDAR YEAR 2010

PORT	COAL, LIGNITE, AND COAL COKE	PETROLEUM AND PETROLEUM PRODUCTS	CHEMICALS AND RELATED PRODUCTS	CRUDE MATERIALS, INEDIBLE EXCEPT FUELS	PRIMARY MANU-FACTURED GOODS	FOOD AND FARM PRODUCTS	MANU-FACTURED EQUIPMENT, MACHINERY	WASTE MATERIAL	UNKNOWN OR NOT ELSEWHERE CLASSIFIED	TOTAL
Aransas Pass	0	134,694	9,661	0	0	815	27,732	0	0	172,902
Beaumont	0	67,118,158	6,235,833	1,340,220	283,733	1,823,799	85,207	0	71,642	76,958,592
Brazos Island Harbor	19,802	2,708,977	42,591	433,469	1,307,612	16,218	24,974	0	0	4,553,643
Brownsville	19,802	2,708,881	42,591	433,469	1,370,593	16,218	24,938	0	0	4,616,492
Corpus Christi	23,223	56,394,685	7,222,098	5,638,142	94,454	4,113,291	170,043	0	6,508	73,662,444
Freeport	0	19,889,366	5,691,411	226,700	76,028	619,564	145,230	0	27,543	26,675,842
Galveston	0	4,850,494	2,854,602	812,203	60,171	4,680,545	312,342	0	78,539	13,648,896
Harbor Island	0	0	0	0	0	0	888	0	0	888
Houston	44,790	153,270,866	42,455,354	5,829,477	9,109,974	11,077,509	4,454,226	1,314	889,721	227,133,231
Matagorda Ship Channel/Port Lavaca/Port Comfort	0	929,712	3,316,342	4,629,745	0	0	2,518	0	874	8,879,191
Orange	0	182,300	315,566	51,210	124,860	200	9,478	0	612	684,226
Port Arthur	6,808	26,254,478	2,835,517	488,366	84,217	1,217	24,269	507,470	29,444	30,231,786
Port Isabel	0	96	0	0	19	0	36	0	0	151
Texas City	0	50,772,693	5,691,996	0	35,827	37,241	50,100	1,314	1,685	56,590,856
Victoria	8,328	163,434	1,589,293	1,031,125	0	0	0	0	0	2,792,180
Total	**122,753**	**385,378,834**	**78,302,855**	**20,914,126**	**12,547,488**	**22,386,617**	**5,331,981**	**510,098**	**1,106,568**	**526,601,320**

Source: U.S. Army Corps of Engineers.

FIGURE 6
PRINCIPAL CARGO AT TEXAS' SEAPORTS, CALENDAR YEAR 2011

SEAPORT	PRINCIPAL IMPORTS	PRINCIPAL EXPORTS
Port of Beaumont	Forest products, aggregate, military cargo, steel, project cargo	Bulk grain, potash, forest products, military cargo, project cargo
Port of Brownsville	Steel slab, hot and cold roll, steel plate, steel beams (billets), iron ore	Steel products, petroleum products, lubricants, grain
Cedar Bayou Navigation District	Unknown	Unknown
Port of Corpus Christi	Crude oil, gas oil, fuel oil, bauxite ore, feed stock, naphtha, condensate, reformate, toluene, frozen beef, fresh fruits	Fuel oil, gasoline, feed stock, diesel alumina, petroleum coke, toluene, cumene gas, oil, asphalt, coal
Port of Freeport	Aggregate, chemicals, clothing, fruits, crude, LNG, paper goods, plastics, windmills	Autos, chemicals, clothing, foods, paper goods, resins, rice
Port of Galveston	Wind power equipment, bananas, agricultural equipment, machinery, vehicles, fertilizer products, lumber products, military-related cargos	Bulk grains, containers, machinery, vehicles, linerboard and paper, carbon black, light fuels
Port of Harlingen	Gasoline, diesel, concrete sand, cement, fertilizer	Raw sugar, grain, cotton
Port of Houston	Petroleum and petroleum products, iron and steel, crude fertilizers and minerals, organic chemicals, wood and articles of wood	Petroleum and petroleum products, organic chemicals, cereals and cereal products, plastics, animal or vegetable fats and oils
Port Isabel	N/A	Ships primarily take rolling stock and cruise passengers, produce and ship shrimp across the U.S.
Port Mansfield	Bulk construction materials, agricultural products/supplies, container-on-barge business, and South Texas Spaceport business	N/A
Port of Port Lavaca – Point Comfort	Bauxite, liquid fertilizer, petrochemical feedstocks	Petrochemical products, alumina
Port of Orange	Provides long-term berthing for ocean going vessels, trransmodal domestic cargo services, barge and tug dry docking, fleeting, repair/ construction of tugs, barges and offshore petroleum drilling rigs, warehousing and packing, and rail and shipping options.	N/A
Port of Palacios	Primarily a fishery with the principal commodity being shrimp	No major direct shipments of import/export cargos
Port of Port Arthur	Steel slabs, wood pulp, newsprint, lumber, plywood, project cargo, military	Linerboard, plywood, steel pipe
Port of Sabine Pass	Primarily a harbor marina.	N/A
Port of Victoria	Transfers liquid and dry bulk and general and project cargos.	Transfers liquid and dry bulk and general and project cargos.

Sources: Port Authority Advisory Commission; Texas Ports Association.

and each seaport's development has been guided by the needs of the local area the seaport serves. As a result, public seaports have different operating structures and relationships with local and state governments. Public seaports in Texas are run by port authorities responsible for managing the facilities in their jurisdiction. This responsibility includes a range of activities such as constructing and maintaining infrastructure, marketing, and management of port assets and services. If a seaport or dock is privately owned, control of property and operations lies with each private property owner. If port authorities and private entities each own property within a seaport, control of dock facilities and operations lie partly with private property owners and partly with the port authority.

The Texas Constitution, Article III, Section 52, authorizes counties, cities, and other political corporations or subdivisions to issue bonds and levy taxes for improving certain waterways to avoid flooding, provide irrigation, and allow for navigation. The Texas Constitution, Article XVI, Section 59, authorizes conservation and reclamation districts for the conservation and development of natural resources, including coastal waters for navigation. The state's public seaports have primarily been established as navigation districts, which are regulated by the Texas Water Code, Chapters 60 through 63. Navigation districts are created when resident property taxpayers in a proposed district submit a petition to a county commissioner's court. The commissioner's court then holds a hearing and, upon approving the establishment of a navigation district, holds an election. The necessary vote for approval of a navigation district depends upon the section of the Texas Constitution the district is created under. Pursuant to the Texas Constitution, Article III, Section 52, a two-thirds vote is required. Pursuant to the Texas Constitution, Article XVI, Section 59, a majority vote is required. Navigation districts are statutorily authorized to issue bonds and levy taxes, have the power of eminent domain, have authority to annex territory under certain conditions, may operate seaport facilities, and may cooperate with the U.S. government.

Legislative session laws (non-codified) also apply to individual seaports. When a port is established via session law, the law usually defines the port's official name and sets forth the ports territory, make-up of its commission, and any special provisions surrounding the navigation district or port authority's ability to tax or issue bonds. In some instances session law also provides specific directives to a navigation district or port authority, such as requiring that protection be provided from fire and explosions, the entity's power to enter into contracts, or gives state land to the entity. **Figure 7** shows the governance structure of Texas' public seaports.

SEAPORT REVENUES

Seaport operations vary and therefore so do their operating revenues and expenses. Revenue sources available to seaports include user fees, taxes, bonds, and federal and state funding. The Port of Houston Authority has the largest operating revenues of the state's public seaports, at $204.7 million during calendar year 2011. The Port of Houston Authority's operating expenses during calendar year 2011 were $193.0 million. The Port of Port Isabel had the lowest operating revenues. In calendar year 2011, operating revenues for the Port of Port Isabel were $586,533 and operating expenses were $650,093. **Figure 8** shows the operating revenues and expenses for each of Texas' public seaports in calendar year 2011.

FIGURE 7
SEAPORT GOVERNANCE CHARACTERISTICS, CALENDAR YEAR 2011

SEAPORT (COMMON NAME)	SEAPORT (LEGAL NAME)	GOVERNING BODY
Port of Beaumont	Port of Beaumont Navigation District of Jefferson County, Texas	Six elected commissioners
Port of Brownsville	Brownsville Navigation District	Five elected commissioners
Cedar Bayou Navigation District	Cedar Bayou Navigation District	Seven appointed commissioners
Port of Corpus Christi	Port of Corpus Christi Authority	Seven appointed commissioners
Port Freeport	Port Freeport	Six elected commissioners
Port of Galveston	Board of Trustees of the Galveston Wharves	Seven appointed trustees
Port of Harlingen	Port of Harlingen Authority	Three elected commissioners
Port of Houston	Port of Houston Authority	Seven appointed commissioners
Port of Port Isabel	Port Isabel San Benito Navigation District	Three elected commissioners
Port of Mansfield	Willacy County Navigation District	Five elected commissioners
Port of Port Lavaca – Point Comfort	Calhoun Port Authority	Six elected board members
Port of Orange	Orange County Navigation and Port District	Five elected commissioners
Port of Palacios	Matagorda County Navigation District No. One	Five elected commissioners
Port of Port Arthur	Port of Port Arthur Navigation District of Jefferson County, Texas	Five elected commissioners
Port of Sabine Pass	Sabine Pass Port Authority	Five elected commissioners
Port of Victoria	Victoria County Navigation District	Five appointed commissioners

Source: Port Authority Advisory Committee.

FIGURE 8
SEAPORT OPERATING REVENUES AND EXPENSES, CALENDAR YEAR 2011 (IN MILLIONS)

SEAPORT (COMMON NAME)	OPERATING REVENUES	OPERATING EXPENSES
Port of Beaumont	$15.3	$18.3
Port of Brownsville	$13.0	$8.4
Cedar Bayou Navigation District	Unknown	Unknown
Port of Corpus Christi	$58.7	$36.6
Port Freeport	$15.6	$12.2
Port of Galveston	$24.8	$22.8
Port of Harlingen	$1.2	$1.1
Port of Houston	$204.7	$139.1
Port of Port Isabel	$0.6	$0.7
Port of Mansfield	$1.2	$1.1
Port of Port Lavaca – Point Comfort	$23.5	$10.5
Port of Orange	$3.0	$2.8
Port of Palacios	$1.6	$1.3
Port of Port Arthur	$11.0	$7.1
Port of Sabine Pass	$1.3	$1.1
Port of Victoria	$2.8	$2.4

Source: Port Authority Advisory Committee.

Operating revenues are derived from a variety of fees and tariffs the seaports charge users. Examples of these include wharfage, dockage, security, storage, or freight handling fees; building, equipment, or land rentals; conference center or warehouse services; foreign-trade-zone user fees; and other services. Operating expenses generally consist of maintenance and operations activities, general and administrative services, and depreciation.

The Texas Transportation Code, Section 54.004, authorizes governing bodies of municipalities to levy ad valorem taxes to pay for the operations and maintenance of a seaport or harbor in their municipality. This tax may not exceed $0.10 of every $100 assessed on property for seaport maintenance and operations and must be approved by voters. These taxes are levied in October and collected by the county in which the seaport or navigation district is located. The seaport or navigation district may pay the county a fee for this collection service and the county remits the tax collected. Statute also authorizes port authorities to issue bonds with the consent of a municipality's governing body. Port governing boards are statutorily authorized to:

- manage, maintain, and operate port improvements and facilities;
- hire officers and employees;
- prepare and adopt budgets;
- set charges for a service or facility;
- authorize expenditures;
- manage and control income and revenue;
- determine policies and adopt rules for port operations;
- acquire property;
- establish a port security force; and
- own, establish, construct, maintain, or operate a transportation facility.

Figure 9 shows the tax rates levied and bonds outstanding for each of Texas' public seaports.

FIGURE 9
SEAPORT TAXES AND BONDS, CALENDAR YEAR 2011

SEAPORT (COMMON NAME)	TAX RATE (PER $100 ASSESSED VALUATION)	TOTAL BONDS OUTSTANDING (IN MILLIONS)
Port of Beaumont	$0.071292	$27.3
Port of Brownsville	$0.00843	$14.4
Cedar Bayou Navigation District	$0.24	N/A
Port of Corpus Christi	None	$7.3
Port Freeport	$0.0535	$44.2
Port of Galveston	$0.0535	$26.6
Port of Harlingen	None	N/A
Port of Houston	$0.01856	$778.2
Port of Port Isabel	None	N/A
Port of Mansfield	$0.07729	N/A
Port of Port Lavaca – Point Comfort	$0.0036	$285.1
Port of Orange	$0.00821	N/A
Port of Palacios	$0.3874	$3.5
Port of Port Arthur	$0.12815	$37.0
Port of Sabine Pass	$0.145865	$1.3
Port of Victoria	$0.0296	$6.5

Note: As reflected at the end of each seaport's fiscal year 2011 (August 31, 2011 for Port Freeport, December 31, 2011 for all other seaports).
Source: Legislative Budget Board.

OTHER FUNDING SOURCES

Seaports are responsible for on-port improvements; however, they also rely on landside connectors to provide access to their markets. Some sources of federal and state revenue may be used for projects relating to these landside connectors. Additionally, state and federal funding for projects relating to coastal erosion, security, and environmental protection are available to seaports.

The federal Harbor Maintenance Tax is assessed on shippers receiving inbound cargo at any U.S. port. It is levied at the rate of 0.125 percent of cargo value and an average of $60 per 40-foot container is collected. The tax is deposited to the Harbor Maintenance Trust Fund, which is used to fund harbor maintenance activities; primarily dredging. Moving Ahead for Progress in the 21st Century (MAP-21), the federal transportation reauthorization legislation, authorized full use of the Harbor Maintenance Trust Fund for harbor maintenance and urged Congress to appropriate the entire fund in fiscal year 2013. In September 2012, Congress passed a continuing resolution that extended fiscal year 2012 appropriations without making additional appropriations. Appropriations from this fund are made to the U.S. Army Corps of Engineers (USACE), the federal entity responsible for navigation channel maintenance. USACE may also participate in new projects such as channel widening or deepening, when authorized by Congress. For example, in 2012 USACE began studying deepening channels at the seaports of Freeport, Corpus Christi, and Brownsville. Seaports may apply for funding from USACE for maintenance and new projects. USACE funds dredging projects entirely while other projects may require matching state funds.

America's Marine Highway Program is a U.S. Department of Transportation program, which began in 2010. This program has identified 18 navigable marine corridors capable of providing additional capacity for freight movement. The program aims to integrate marine highways and the country's surface transportation system. A total of $7 million in grants were issued through a competitive process in 2010. The Texas Gulf Coast is part of the M-10 corridor and is involved in one project funded through the Marine Highway Program. The Gulf Coast Project is working to reestablish service to transport freight, including hazardous freight and oversize/overweight loads, via barge instead of truck. This project covers an area from Brownsville, Texas to Manatee, Florida. It is expected to provide an alternative to freight traveling on Interstate 10 and avoid freight traveling through several urban areas, including Houston.

The federal America Recovery and Reinvestment Act of 2009 (ARRA) included $1.5 billion for discretionary grants for surface transportation. From 2009 to June 2012, three rounds of federal Transportation Investment Generating Economic Recovery (TIGER) discretionary grant awards were announced. Seaport projects received a portion of this grant funding, including a project to construct a cargo dock at the Port of Brownsville and a rail expansion project at the Port of Corpus Christi.

The federal Transportation Infrastructure Finance and Innovation Act (TIFIA) provides assistance for significant land transportation projects. This legislation was enacted in 1998 and authorized the U.S. Department of Transportation to provide secure loans, loan guarantees, and standby lines of credit to major surface transportation projects. These forms of credit are intended to generate private and non-federal co-investment in projects improving the surface transportation system. Seaport projects related to facilitating direct intermodal interchange, transfer, and access into and out of the seaport are eligible projects for TIFIA assistance. However, eligibility thresholds such as the minimum cost of the project mean many seaport projects are not eligible for this funding source. As of fiscal year 2012, no Texas seaports have received TIFIA assistance.

The State Infrastructure Bank (SIB) began in 1995, and Texas was chosen as one of 10 pilot states. Texas' SIB was authorized in 1997 and is overseen by the Texas Transportation Commission. It operates as a revolving loan program in the State Highway Fund, which provides lower interest rates to local entities constructing federally approved surface transportation projects. The SIB program requires that federal funds must be matched with state funds. As of the end of fiscal year 2011, no Texas seaports had received SIB loans.

In 2001, the Texas Legislature established the Port Access Account Fund. As of the end of fiscal year 2012, this fund has never been capitalized. However, several other state programs can provide funding for seaport-related projects. The Texas Department of Transportation (TxDOT) has worked with several seaports to build new or expand existing connector projects with seaports. In these instances, TxDOT may be able to use state sources of road funding such as the State Highway Fund or Texas Mobility Fund. TxDOT has also worked with seaports to solve issues related to at-grade

rail crossings caused by rail traffic originating from the state's seaports.

State statute authorizes some Texas seaports to assess fees for oversize or overweight permits. The Texas Transportation Code authorizes the Port of Corpus Christi Authority to issue permits for the movement of oversize or overweight vehicles that carry cargo on a roadway it owns and maintains. These permits cannot exceed $80 per trip and are required to be used for the construction and maintenance of port authority roadways. Statute also established a special freight corridor in San Patricio County specifically for the movement of oversize or overweight vehicles carrying cargo to and from the Port of Corpus Christi's La Quinta terminal. Statute authorizes the Port of Corpus Christi Authority to issue permits for oversize or overweight vehicles transporting cargo on this freight corridor if the cargo weighs less than 125,000 pounds. These fees, which are deposited to the State Highway Fund, may not exceed $80 per trip and are used only for the administration and maintenance of the special freight corridor.

The Victoria County Navigation District and Port of Brownsville are authorized to collect fees for oversize or overweight vehicles carrying cargo in certain areas. The Victoria County Navigation District fee cannot exceed $100 per trip and the Port of Brownsville fee cannot exceed $80 per trip. In both cases, the authority is allowed to retain administrative costs but the remainder of the fees must be deposited to the State Highway Fund for maintenance and improvements of certain roadways.

The Coastal Erosion Planning and Response Act (CEPRA) was passed by the Texas Legislature to help address coastal erosion along the Texas Gulf Coast. Administered by the General Land Office (GLO), projects undertaken within the CEPRA program have helped to replenish and stabilize critically eroding areas of Texas beaches. The CEPRA program funds the following types of erosion control projects: study/monitoring, shoreline protection, beach nourishment, habitat restoration, dune restoration, beneficial use of dredged material, structural removal, damage assessment, and debris removal. However, to date, no seaports have directly received CEPRA funding. GLO also administers several federal programs related to coastal management. The Coastal Impact Assessment Program (CIAP) provides funds directly to Texas' coastal counties as well as state, federal, county, and local governments; other state subdivisions; universities; and non-profit organizations. These funds can be used for planning and projects relating to environmental issues, including onshore infrastructure projects. The Port of Corpus Christi and Calhoun Port Authority have both received CIAP funding. The Coastal Management Program (CMP) funds projects that manage coastal natural resource areas to ensure the long-term environmental and economic health of the coast. Program funds primarily go to state and local entities. The Calhoun Port Authority, Port of Houston Authority, and Willacy County Navigation District have all been direct recipients of CMP funds.

The Texas Emissions Reduction Program (TERP) is administered by the Texas Commission on Environmental Quality. The program provides financial incentives for eligible individuals, businesses, and local governments to reduce emissions from polluting vehicles and equipment. Port Freeport and the Port of Houston Authority have both been past recipients of TERP grants and have used the funds for equipment purchases, repowerment, and replacement.

GULF INTRACOASTAL WATERWAY

The Gulf Intracoastal Waterway (GIWW) is a single canal that connects all major Gulf Coast seaports. At its full length, the GIWW is 1,300 miles long; the Texas portion is 423 miles. In 2008, 69 million tons of cargo was moved via the GIWW in Texas, which accounted for 58 percent of the waterway's traffic. This cargo included 43 million tons of petroleum and petroleum products, 17 million tons of chemicals and related products, and 9 million tons of dry cargo. Approximately 70 percent to 80 percent of freight moved via the GIWW traveled between the Sabine River and Galveston; 30 percent to 40 percent traveled between Galveston and Corpus Christi, and less than 5 percent moved between Corpus Christi and the Mexico border. The GIWW is also used for recreational purposes and other commercial interests. Recreational uses include fishing, skiing, and sightseeing. The waterway is used for harvesting fish and shellfish, and by the gulf and coastal oil and gas industry.

Moving goods via the GIWW is considered more efficient than using other modes of transportation. According to TxDOT, one barge can carry the same amount that 15 railcars or 60 trucks can transport. One gallon of fuel allows one ton of cargo to be transported 576 miles on a barge, 413 miles on rail, and 155 miles on truck. Barge transportation produces 28 percent less air emissions than rail and 40 percent less than trucks. Additionally, barge movement had the lowest number of documented hazardous spills in Texas in 2009.

The U.S. Army Corps of Engineers (USACE) is responsible for dredging the GIWW; dredging costs are 100 percent federally funded. During fiscal year 2010, $36.6 million in Federal Funds was expended on the Texas GIWW. However, costs to dredge and maintain the GIWW have increased and funding provided for these operations has not increased. Consequently, USACE has deferred and downsized its projects so the GIWW is not maintained entirely at its authorized depth. As a result, barge operators have had to transport smaller loads, which increases shipping time and costs.

TxDOT is the non-federal sponsor of the Texas GIWW. Its primary duty is to provide areas for disposal of dredged material; there are currently more than 200 of these areas. TxDOT has acquired land for the disposal of dredge material. The last acquisition was finalized during fiscal year 2010; TxDOT paid $1.8 million for 242 acres in Galveston County.

SEAPORT OPERATIONS

Navigation channels are marked on nautical charts and by buoys, lights, and other navigation aids on the water. They are often deeper than the surrounding ocean floor and considered areas of safe passage for ships. Deep draft channels are generally located at larger seaports and are used by larger vessels. Alternatively, shallow draft channels are mostly used by barge and small vessel traffic. Both types of channels handle high quantities of bulk cargo, but containerized and high-value per-ton cargo more often traverse deep draft channels.

Sediment deposits build up on the ocean bottom, which can cause the floor of the navigation channel to become shallower than what is shown on nautical charts. If a vessel grounds or strikes the ocean floor, both the vessel and its contents can be damaged. To prevent this, maintenance dredging is done periodically to keep navigation channels clear and safe. In Texas, USACE maintains more than 1,000 miles of navigation channels. Each USACE dredging project is required to have a non-federal sponsor. The seaports themselves are the non-federal sponsor of navigation channel projects in Texas.

Dredging is done using a machine that scoops or sucks sediment from the bottom of waterways. One of the most problematic aspects of dredging is determining what to do with dredged material. As the non-federal sponsor of dredging projects, Texas seaports and TxDOT are responsible for developing beneficial uses for dredged material. Clean dredged material may be taken to a designated site in the ocean for disposal. It may also be used on or near a beach to replenish an eroding beach or wetland. Another option is to place the material in a confined disposal facility, which is an area that has been contained and isolated from its surroundings. Dredged material is placed into the disposal facility along with water. The dredged material settles out and the clean water is released. Any type of dredged material may be placed into a confined disposal facility. If dredged material has been contaminated with harmful elements, such as metals or chemicals, it may need to be disposed of in a special manner to prevent contaminants from re-entering the environment. This practice is known as capped disposal. In these instances, the harmful dredged material is buried low and clean material is placed on top to form a cap covering the contaminated sediment. This cap is designed to stay in place and is continuously monitored.

Dock facilities are on the water's edge and are the location at which ships are loaded or unloaded. Equipment such as cranes, conveyors, and forklifts may be used at the dock to help load and unload a ship's cargo. Seaports may have more than one docking facility, and some of these may be devoted to handling one type of cargo. For instance, steel mills, power plants, or oil refineries may have a dock facility dedicated to their use. In some instances, a private company owns the docking facility. Port authorities also own their own facilities, and may lease them to private operators or operate a dock themselves.

Freight travels to seaports on roadways and railways to be loaded onto ships and transported. Seaports are also points of distribution for freight arriving on ships. This freight is unloaded from ships and transported to other parts of the state or country via rail, truck, or water traveling barges. Seaports provide services to ships by operating and maintaining berths, docks, navigation channels, cranes and warehouses.

Shippers consider several factors other than cost when determining at which seaport their ship will dock. The size of the ship may necessitate deep waterways or a large terminal. Adequate space must be available for handling and warehousing a product. Access to road and rail facilities, and the capacity of each, can influence a shipper's decision on where to dock. However, maritime companies choose where to ship and as business and demand changes, choices on where to dock a ship may also change. The final destination of container traffic may fluctuate. However, some forms of cargo have less flexibility. For instance, oil refineries have

specialized storage and infrastructure needs. Once these facilities are developed at a seaport, an oil refinery is not as likely to use an alternative seaport as other less specialized cargo such as containers.

HARBOR PILOTS

Harbor pilots are mariners who operate large ships using a seaport in their home district. The pilots are transported to and board ships approaching a seaport because of their knowledge of the waterway and familiarity with local vessel traffic and seaport procedures. A pilot does not replace the ship's master in command, but is hired to offer advice for navigating the ship channel.

The Texas Transportation Code requires all private vessels over 20 gross tons to obtain a pilot when they are moving on a river, bay, harbor, or port in Texas. The only exceptions are for motorboats registered in Texas and documented U.S. vessels licensed for coast-wide trade. Pilot boards for navigation districts are statutorily authorized in the Texas Transportation Code. They have the authority to appoint, suspend, or dismiss a pilot in their district; establish pilotage rates, and adopt and enforce rules regulating pilots, and are required to administer a qualification exam to pilots. The Governor appoints pilot boards for all seaports except the Port of Houston. These boards are statutorily required to examine pilots, recommend new pilot appointments to the Governor, examine alleged misconduct of a pilot and hear disputes involving pilots, and award compensation time to pilots. They may suspend pilots and adopt pilotage rates for their jurisdiction. The Port of Houston Authority Commission acts as the pilot board for the Houston Navigation Channel.

Maximum pilotage rates are set forth in statute as $6.50 for each foot of water the vessel draws while piloted. Pilot boards for seaports in Houston, Galveston County, Brazoria County, Orange, Port Arthur, Beaumont, privately owned docks in Orange and Jefferson counties, and navigation district pilot boards are allowed to set their own pilotage rates that are not subject to this maximum. Statute sets the pilotage rate for Matagorda and Lavaca Bays at $2.50 for each foot of water the vessel draws while piloted.

Once a ship is navigated through a channel, it is taken to a terminal. This is an assigned area where vessels are unloaded. At the terminal, the ship ties up to a dock, which is a cargo handling area parallel to the shoreline. There are several kinds of terminals. Some seaports include multiple terminal types while those specializing in one or two cargos may have only one type of terminal. **Figure 10** shows select facilities at each of Texas' public seaports.

BULK AND LIQUID BULK TERMINALS

Most seaports have bulk terminals. Cargo not placed in a container or driven onto a ship is known as break-bulk cargo. Break-bulk cargo refers to loose, non-containerized cargo or packaged cargo that is not containerized. When break-bulk cargo is loaded or unloaded, either a portion or all the contents of a ship is moved piece by piece and distributed accordingly. It is usually moved in a box, bale, or other unit. Break-bulk cargo is measured through a unit known as short tons; which is equivalent to 2,000 pounds. Bulk cargo is not transported in packages or containers; instead, it is shipped loose. Bulk carriers transport large amounts of any loose, dry or liquid cargo that can be conveyed, grabbed, pumped, or blown into its storage hold. Ships transporting this type of cargo primarily transport minerals such as iron ore and coal, as well as grains. Some bulk carriers are specialized to carry products such as cement or woodchips. They dock at specialized terminals with equipment designed to move their cargo quickly. These terminals also need access to a large storage area for the cargo, and some may have grain elevators or other specialized storage facilities.

One of the most specialized terminals is for liquid-bulk cargo. Ships that carry liquid-bulk cargo are known as tankers. Liquid-bulk cargo can include crude oil, petroleum products, such as gasoline or diesel, and other chemicals and oils, such as liquefied petroleum gas and methane, wine, molasses, and similar products. At oil terminals, ships pump their cargo into shore-side tanks. Oil terminals may be import points for oil and other products where the product is then shipped to oil refineries by smaller vessels, trucks, or rail. In Texas, oil arriving on ocean vessels is usually refined at the seaport. ExxonMobil operates an oil refinery at the Port of Houston. This operation is the largest oil refinery in the U.S. and allows ships to transport oil directly to the refinery.

CONTAINER TERMINALS

A container is a truck trailer body that can be detached from a truck chassis and loaded onto a vessel or rail car. Containers can be ventilated, insulated, refrigerated, have open tops, or other interior devices or special adaptations, for a variety of cargo types. Containers are measured by a common unit of freight known as a 20-foot equivalent unit (TEU). A 40-foot equivalent unit is counted as two TEUs. Containers carry a variety of cargo types that include, but are not limited to, clothing, electronics, and wood and paper products.

FIGURE 10
SELECT FACILITIES AT TEXAS PORTS, FISCAL YEAR 2012

PORT	LIQUID CARGO DOCKS	DRY CARGO DOCKS	BULK MATERIALS DOCKS	GENERAL CARGO DOCKS	CRUISE TERMINAL	ROLL-ON ROLL-OFF CARGO	GRAIN ELEVATOR	VESSEL REPAIR/ SHIPYARD OPERATION
Port of Beaumont	X	X	X			X		X
Port of Brownsville	X	X	X	X			X	X
Cedar Bayou Navigation District								
Port of Corpus Christi	X	X	X					
Port Freeport		X		X		X		
Port of Galveston	X		X		X	X	X	
Port of Harlingen	X	X	X					
Port of Houston	X	X	X	X	X		X	
Port of Port Isabel								X
Port of Mansfield	X		X			X		
Port of Port Lavaca – Point Comfort	X	X	X	X		X		
Port of Orange			X	X		X		X
Port of Palacios								X
Port of Port Arthur		X	X	X		X		
Port of Sabine Pass								
Port of Victoria	X	X		X				X

Source: Legislative Budget Board.

Container terminals are designed to handle the loading and unloading of containers from ships, and to store them until they are transported from the terminal. Containers are stacked in rows and may be transported to and from the ship by trucks or rail. Container terminals have gantry cranes that extend over ships to load or unload the containers. These cranes are rail-mounted and can move along the dock to handle cargo. They lock onto a container, lift it, and place the container on a carrier that takes the container to its storage spot or puts it directly on a truck or train. Container cargo is tracked closely and shipped in a sequence that prevents a container from needing to be moved more than once when it is unloaded.

Containerized goods are packed once prior to being loaded on the ship. The goods typically remain packed while the container is loaded onto the ship, transported via water, and transported to its final destination by truck or rail. Since the cargo is packed once, its chances of being lost or damaged are greatly reduced, compared to transporting individual packages.

ROLL-ON ROLL-OFF AND CRUISE TERMINALS

A roll-on, roll-off (ro-ro) ship has ramps that allow wheeled and mobile cargo to be loaded without using cranes. Instead, cargo is unloaded over a bow, stern, or ramp. Ferries transporting motor vehicles are a common example of this type of ship. Ro-ro terminals often have a large amount of space for freight storage. Speed is important at these terminals, as it is expected the entire load will be ready to roll onto or off of the ship when the ship is ready. The cargo is also loaded in a specific, planned order for quick loading and unloading. These loads are measured in short tons.

Cruise ships carry passengers from one destination to another. At home-based seaports, passengers embark and have their final disembarkment at the same seaport. Seaports may also be a port-of-call, meaning they are a stop for cruise ships but not an embarkation or disembarkation point. Cruise terminals typically include parking facilities and offer space for luggage handling. The Port of Galveston is the primary home-based seaport for cruise ships operating in Texas.

STEVEDORES AND LONGSHOREMEN

Ships generate income by transporting cargo; therefore, shippers try to move cargo onto and off a ship as quickly as possible to reduce a ship's idle time. A stevedore is an individual or firm that employs longshoremen contracted to load or unload ships. They ensure sufficient labor and resources are available to load or unload cargo when a ship arrives at a seaport. These resources include gantry cranes, carriers to move containers around the seaport, and specialized equipment for niche cargos, such as rolling cargo or indivisible loads. Stevedores are also responsible for organizing cargo so the minimum amount of time is required to move it once it is unloaded. They ensure cargo is secured and properly stowed so it is not damaged during shipping, which could cause the ship to trim or list.

Stevedores manage the movement of a ship's cargo; longshoremen are employed by stevedores and handle the cargo directly. Longshoremen tie the ship to the dock when it arrives, inspect containers and other cargo on the ship, and remove the cargo. If the cargo can be driven, longshoremen drive it off the ship. Otherwise, they operate the equipment used to transfer cargo to and from the ship.

SEAPORT AND CARGO SECURITY

The U.S. Coast Guard (USCG) is the federal entity responsible for protecting waterways, vessels, and maritime facilities. U.S. Customs and Border Protection (CBP) is the federal entity responsible for cargo security and screening. Port authorities are responsible for securing the perimeter at terminals, limiting access to restricted property, and meeting other regulatory requirements pertaining to security. Terminals operated by the private sector have the same responsibilities as port authorities.

Cargo arriving at a seaport from an international destination must pass through customs. This occurs either at a foreign seaport or once cargo is offloaded at a U.S. seaport. The Department of Homeland Security, through the Container Security Initiative, works with customs services in host countries to examine high-risk maritime containerized cargo before it leaves its country of origin. Additionally, Radiation Portal Monitors and other radiation detection technologies scan more than 99 percent of containers arriving from sea.

Before arrival at a seaport, a ship must provide the USCG with the name of the ship, the name of its operators and all crew, the cargo being transported, and its destinations. The USCG and CBP use this information to determine if they need to inspect a ship's cargo. During an inspection, authorities open and inspect a sample of containers before the ship is unloaded.

The Texas Legislature established the Houston Ship Channel District in 2007. This district is a public/private partnership between the Houston seaport's terminals and industry. A fee is assessed on facilities to fund security initiatives benefitting the stakeholders. This district is overseen by an 11-member board of directors consisting of eight industry appointees and three local government appointees. Some seaports, including the Port of Houston Authority, have their own fire-fighting boats, rescue boats, and port police. Port police officers are state certified through the Texas Commission on Law Enforcement Standards and Education.

The federal Port Security Grant Program provides funding to port authorities, facility operators, and state and local government agencies required to provide security services. The federal government classifies ports into three groups based on their perceived risk, and competitively apportions grant funds to ports based on their designation. The highest risk designation is one, while the lowest risk group is not given a designation but referred to as "all other port areas." Public sector applicants must match at least 25 percent of the total project cost for grants received through this program. Texas seaports fall into all three categories, as shown in **Figure 11**.

FIGURE 11
PORT SECURITY GRANT PROGRAM CLASSIFICATIONS, FEDERAL FISCAL YEAR 2012

FEMA DESIGNATION	SEAPORT
1	Houston, Galveston, Texas City
2	Beaumont, Orange, Port Arthur, Corpus Christi, Freeport
3	Port Lavaca–Point Comfort, Victoria Brownsville

Note: Eligible entities not located within one of the port areas identified above are eligible to compete for funding in within the "All Other Port Areas" group.
Source: Federal Emergency Management Association.

FOREIGN TRADE ZONES

A foreign trade zone (FTZ) is a free port in a country that does not have a customs authority, but is still under government control. Cargo within a FTZ, unless specifically prohibited, can be stored, exhibited, assembled, manufactured, and processed in the FTZ without being subject to import duty regulations. When the cargo leaves

the FTZ it is exempt from duties if it is exported from the U.S. If it remains in the country, duties and excise taxes will be due when the cargo leaves the FTZ.

The federal government must approve the establishment of a FTZ. However, the state has authorized the establishment of these zones in the Texas Business and Commerce Code, Chapter 681. The following public seaports include one or more FTZs:

- Port of Galveston;
- Brownsville Navigation District;
- Port of Houston Authority;
- Port Arthur;
- Port Beaumont;
- Port of Orange;
- Port of Corpus Christi Authority;
- Port Freeport; and
- Calhoun/Victoria Counties.

These seaports receive revenue as a result of their FTZ status in the form of user fees.

Texas' seaports vary in size, operations, and governance. However, they all contribute to the state's economy and are some of the most active seaports in the country. The role of Texas' seaports in trade is expected to continue to increase as the state's population and economy expand, and as shipping and trade patterns evolve.

BETTER INTEGRATE SEAPORT CONNECTIVITY WITH THE STATE'S TRANSPORTATION PLANNING PROCESSES

The Texas Department of Transportation estimates more than 766 million tons of trade will move through Texas waterways by 2030. This is almost double the volume of the state's waterborne trade in 2008 and would significantly increase the amount of freight traveling on the state's highway and rail system. Seaports are only one component of Texas' freight transportation system. Delivering freight to its final destination usually involves a multimodal approach in which ships are combined with trains, trucks, and/or aircraft.

As usage of Texas' seaports increases, the state needs to plan and prepare for the impact of this growth on our transportation system. State-level transportation planning should incorporate changes in seaport activities that affect freight traveling through the state. This requires coordination between state agencies responsible for overseeing activities at seaports and the seaports themselves, which are responsible for their individual development. However, differences in seaport planning processes and the state's transportation planning process make this coordination difficult. Addressing challenges in these two planning processes will allow the state to better align future transportation projects with needs resulting from increased freight transportation.

FACTS AND FINDINGS

- ♦ The Texas Department of Transportation and local planning authorities have planning documents that include the development of projects over a period of 20 or more years. For a surface transportation project to receive federal funding, it must be included in the Statewide Transportation Improvement Plan. The U.S. Department of Transportation approves this plan every four years.
- ♦ Texas' seaports are not required to have strategic or capital plans, and many of the state's public seaports do not have formal processes for the development of either of these plans.
- ♦ The Texas Port Authority Advisory Committee, made up of 7 representatives from the state's seaports, is statutorily required to biennially prepare a maritime port mission plan and a Port Capital Improvement Program. The plan must include recommendations for approval or disapproval of seaport projects.

CONCERNS

- ♦ Freight traveling to and from Texas' seaports affects the state's highway and rail transportation system. However, differences in planning processes at the seaport and state levels make it difficult for the state to adequately plan for transportation projects needed as a result of changing seaport usage.
- ♦ Texas' public seaports have expressed concern that the state's transportation system is not prepared to accommodate increases in freight traffic. Some public seaports have already experienced road and rail congestion because of inadequate transportation infrastructure linking to their seaport.
- ♦ The current Port Capital Improvement Program has not been an effective tool for planning and prioritization of transportation projects. The plan includes projects that may be eligible for funding sources overseen by state agencies other than the Texas Department of Transportation. The program is not provided to these agencies and the only funding source considered in the program is the Port Access Account Fund, which has never received funding.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Amend statute to include projects relating to access at a seaport for consideration in the Statewide Transportation Improvement Program.
- ♦ **Recommendation 2:** Amend statute to expand required distribution of the Port Capital Improvement Program to include the General Land Office, Texas Commission on Environmental Quality, and Department of Public Safety.
- ♦ **Recommendation 3:** Amend statute to remove the requirement for the Port Authority Advisory Committee to prioritize projects in the Port Capital Improvement Program and refine the program's scope and requirements so it is more useful for state transportation planning purposes.
- ♦ **Recommendation 4:** Amend statute to require the Port Authority Advisory Committee, in collaboration

with the Texas Department of Transportation, to agree upon productivity measures to be reported by seaports in the Port Capital Improvement Program to augment state planning related to highway and rail connectivity to seaports.

- ♦ **Recommendation 5:** Amend statute to include staff from the Texas Department of Transportation on the Port Authority Advisory Committee.

DISCUSSION

The Texas economy accounts for approximately 9.0 percent of the national gross domestic product. In 2011, Texas was the leading export state by value in the U.S. Exports from Texas were worth $251 billion, accounting for 14.0 percent of the U.S.' total exports. Imports to Texas were valued at $309 billion; accounting for 22.0 percent of all U.S. imports. The manufacturing and mining sectors comprise 24.3 percent of the state's gross domestic product. These sectors along with wholesale trade, retail trade, construction, transportation and warehousing, agriculture, and forestry (which, combined, make up an additional 21.1 percent of the state's gross domestic product) all rely on freight movement.

According to the Port Authority Advisory Committee, Texas has 20 public seaports and numerous private facilities. The state's seaports are diverse. Some specialize in specific commodities while others have operations supporting a variety of products. Texas' seaports are an entry and exit point for much of the state and country's trade. In 2008, 473 million tons of cargo was traded through Texas' seaports; accounting for 19.0 percent of U.S. seaport tonnage. This amount includes 353 million tons of international trade, 62 million tons of domestic cargo, and 59 million tons of intrastate cargo moving between seaports.

Texas has approximately 80,000 roadway centerline miles and 11,000 rail miles that help move cargo from seaports. The Texas portion of the Gulf Intracoastal Waterway extends 423 miles and handled 69 million tons of cargo in 2008. The state also has approximately 300 airports, including 27 commercial service airports. **Figure 1** shows the amount of freight moved by each mode of transportation in 2008. From 2008 to 2035, the total amount of freight transported by these modes is projected to increase 82.0 percent.

FIGURE 1
TEXAS FREIGHT SUMMARY BY MODE (IN MILLION TONS), CALENDAR YEARS 2008 AND 2035

MODE	ACTUAL 2008	PROJECTED 2035	PERCENTAGE CHANGE
Air, Air and Truck	0.8	0.9	12.5
Other Intermodal	11.2	30.6	173.2
Pipeline and Unknown	796.2	1,351.1	69.7
Rail and Rail/Truck	307.7	545.7	77.4
Truck	1,177.3	2,251.2	91.2
Water	96.5	168.9	75.0
Total	**2,389.7**	**4,348.4**	**82.0**

SOURCE: Texas Department of Transportation.

INCREASING USE OF TEXAS SEAPORTS

The Panama Canal is being expanded in a project slated for completion in 2015. This expansion will allow larger ships to travel through the canal and is expected to increase annual capacity by more than 75 percent. The largest ship operating today has a draft of 51 feet. The Panama Canal expansion will accommodate ships with a 50-foot draft and is expected to increase the industry's conversion to larger ships. No Texas seaports can receive the largest ships that will be able to travel through the canal based on their current channel depth. The Panama Canal expansion will influence new trading patterns and allow super-sized vessels to come to Gulf of Mexico ports. However, opinions as to how sizeable the international fleet of these larger ships will be and the demand for these ships to dock at Texas' seaports vary.

The exact impact of the Panama Canal expansion on Texas has not been determined. Indications are that ship traffic to Texas' seaports will increase with the expansion. The Panama Canal Authority estimates 508 million tons will transit the canal in 2025. If this growth is evenly distributed among U.S. ports, Texas will receive an additional 6.6 million tons of cargo from the canal and export an additional 15 million tons. In 2010, the Texas Department of Transportation (TxDOT) reported the Panama Canal expansion will provide U.S. ports along the East Coast and Gulf of Mexico direct, all-ocean service from Asia. Currently, approximately 14.0 percent of container traffic handled by the Port of Houston goes through the Panama Canal. Officials have estimated this traffic could be as high as 25.0 percent by 2020. Analysts have projected as much as 20 percent of cargo ships now docking at West Coast seaports could divert to Houston once the Panama Canal widening is complete. Overall, more

ships are expected to shift to East and Gulf Coast seaports and container trade is expected to be the largest gainer.

Use of Texas' seaports is increasing regardless of expansion activities in the Panama Canal. The Port of Houston reports it already receives cargo diverted from the West Coast and expects to see a 15.0 percent increase in cargo before the canal expansion opens. Other seaports also expect increases in trade through 2035. **Figure 2** shows the amount of foreign exports and imports at Texas' seaports in 2008 and amounts expected in 2035.

The Center for Transportation Research attributes growth at Texas' seaports to the state's growing population and economy, which have resulted in an increased demand for imports. The adoption of shipping containers to transport goods previously shipped via other methods and fundamental shifts in trade and economic policies are also cited as contributing factors.

Shippers aim to find the most efficient and cost effective method of transporting goods. Reliability in supply chain logistics, including road and rail service, are also a key consideration in choosing a port. Therefore, connectivity with rail, truck, and water access affect shippers decisions to use Texas' seaports. Increases in the amount of goods going through Texas' seaports places demands on railroads and commercial trucks that serve seaports as well as inland warehouses and distribution centers that support the entire multimodal freight supply chain. Improvements to land transportation infrastructure can help to alleviate this demand and help keep Texas' ports competitive. Without effective planning, the traffic and congestion impacts of trade being transported through the seaports will increase as activity at seaports continues to grow.

TRANSPORTATION PLANNING IN TEXAS

The state's transportation planning and project selection process involves numerous steps. These range from plans with 24-year long-range goals to plans for an individual project. Throughout the process, projects are refined to meet state and regional transportation objectives. Details of these plans are shown in **Figure 3**.

The Texas Transportation Code and federal law requires TxDOT to develop a Statewide Long-Range Transportation Plan (SLRTP), covering a 24-year period. The SLRTP must contain all modes of transportation, including water traffic. This plan is required to be updated at least every four years.

FIGURE 2
TEXAS SEAPORT FOREIGN EXPORTS/IMPORTS (IN MILLION TONS), CALENDAR YEARS 2008 AND 2035

SEAPORT REGION	ACTUAL 2008 FOREIGN EXPORTS	ACTUAL 2008 FOREIGN IMPORTS	ACTUAL 2008 TOTAL	PROJECTED 2035 FOREIGN EXPORTS	PROJECTED 2035 FOREIGN IMPORTS	PROJECTED 2035 TOTAL	PERCENTAGE CHANGE
Brownsville/Hidalgo	0.5	0.4	0.9	0.3	1.4	1.7	93.0
Houston	55.1	83.4	138.5	91.8	122.9	214.7	55.0
Beaumont	7.9	49.1	57.0	10.6	78.3	88.9	56.0
Corpus Christi	12.7	50.9	63.6	19.4	59.6	79.0	24.0
All Other Texas Seaports	22.2	75.0	97.2	38.9	99.1	138.0	42.0
Total Tons	**98.3**	**258.8**	**357.1**	**161.0**	**361.2**	**522.3**	**46.0**

SOURCE: Texas Department of Transportation.

FIGURE 3
TEXAS TRANSPORTATION PLANNING AND PROGRAMMING PROCESS, FISCAL YEAR 2012

PROGRAMMING PROCESS	STATEWIDE LONG-RANGE TRANSPORTATION PLAN	METROPOLITAN TRANSPORTATION PLANS	UNIFIED TRANSPORTATION PROGRAM	STATEWIDE TRANSPORTATION IMPROVEMENT PROGRAM
Entity Responsible For Creating	Texas Department of Transportation	Metropolitan Planning Organizations	Texas Department of Transportation	Texas Department of Transportation
Approved By	Texas Transportation Commission	Metropolitan Planning Organizations	Texas Transportation Commission	Federal Highway Administration
Length of Plan	24 years	20 years	10 years	4 years

SOURCE: Legislative Budget Board.

Federal and state statutes require TxDOT to collaborate with metropolitan planning organizations (MPO) to develop assumptions to guide long-term planning in the SLRTP.

The Texas Transportation Code requires TxDOT to annually update the Unified Transportation Program (UTP), which covers the first 10 years of the 24-year SLRTP. The UTP identifies target-funding levels and lists all projects TxDOT intends to develop or begin constructing during the program period. Statute requires projects related to ports of entry to be included in the UTP. A port of entry is statutorily defined as "a place designated by executive order of the President of the United States, by order of the U.S. Secretary of the Treasury, or by an act of the U.S. Congress at which a customs officer is authorized to accept entries of merchandise to collect duties, and to enforce the various provisions of the customs and navigation laws." An MPO with a port of entry in its jurisdiction is required to include projects related to those ports in its metropolitan transportation plans. However, the Texas Transportation Code also limits this requirement for MPOs to transportation projects on the state highway system that relate to access to ports of entry on the Mexico border. This means that seaport-related transportation projects are not required to be included in metropolitan transportation plans, although they are not statutorily excluded.

Projects within the first four years of the UTP are included in the four-year financial plan known as the Statewide Transportation Improvement Program (STIP). During this period, available funding is more certain and project development activities are being completed so construction estimates are more precise. Projects in the STIP are approved by the Federal Highway Administration and Federal Transit Administration. Without this approval, a project is not eligible to receive federal funds.

Since MPO's play a required role in the development of both the SLRTP and the UTP, whether or not a seaport-related project is included in either of these plans can be affected by the level of coordination between MPOs and seaports. Therefore, a project's chance of inclusion in the STIP and its ability to receive federal funding is also dependent on this relationship. Recommendation 1 would amend the Texas Transportation Code to specify that projects on the state highway system relating to access at a seaport should be considered in the STIP. This amendment would require all seaport-related projects to be considered, rather than only projects relating to access at a port of entry on the Texas/ Mexico border as is currently required.

COORDINATION OF SEAPORT ACTIVITIES IN TEXAS

Each of the state's seaports is responsible for its own planning efforts. This independence allows seaports flexibility to respond to their business environments. Seaports adopt their own mission and goals, and in some cases a master or strategic plan. Seaports are accountable to their own governing board, collect their own revenues, and make spending decisions based on their own plans, strategies, and needs. Seaports function independently of each other and cooperation between seaports is generally the choice of the seaports rather than the result of a state directive. In some markets, the seaports also compete with each other to attract the same business.

According to TxDOT, seaports have medium- and long-term strategies for capacity expansion because of increasing trade. However, Legislative Budget Board staff found that not all seaports have written plans for managing growth, and no consistent planning protocols are in place. At some ports, commissioners meet regularly to determine the seaport's direction and priorities; some seaports have recently developed more formalized strategic planning processes; and others have more mature planning processes in place.

At the state level, there is one statutory requirement regarding seaport planning. The Port Authority Advisory Committee is established in the Texas Transportation Code. It is made up of seven seaport representatives; one from the Port of Houston Authority, three from seaports on the upper Texas coast, and three from seaports on the lower Texas coast. Statute requires the committee to prepare a maritime port mission plan, review projects eligible for funding, make recommendations for funding, and biennially prepare a report on Texas maritime ports with a list of recommended projects. To meet this requirement the committee biennially prepares the Port Capital Improvement Program (CIP), which is published by TxDOT. The 2011–2012 CIP identified 81 projects costing $672.6 million, and proposes that the state fund half the project costs, or $336.3 million. The report states "these capital projects do not represent nor are they intended to represent a comprehensive listing of all capital needs of Texas seaports."

The proposed funding source for projects included in the CIP is the Port Access Account Fund, which was established in the Texas Transportation Code. Statutorily permitted uses of fund monies include seaport security projects; maritime port studies; and facility projects, such as the improvement of transportation facilities, dredging, construction or improvement of seaport or security facilities, the acquisition

of seaport-related equipment or land, and certain environmental protection projects. However, the fund has never been capitalized.

IMPROVE COORDINATION OF SEAPORTS CAPITAL PROJECTS IN TEXAS

Differences in planning processes across seaports as well between ports and TxDOT's planning requirements reduce the state's ability to prepare for changes to road and rail connections to and from Texas' seaports. Seaports are responsible for on-port improvements. TxDOT is the state agency primarily responsible for projects relating to roads and rail that freight travels on from the state's seaports. Local entities such as MPOs are also responsible for identifying needed projects. In 2010, TxDOT completed the Waterborne Freight Corridor Study. In this study, TxDOT noted

> "TxDOT Districts, metropolitan planning organizations (MPO), ports, and railroads along the Gulf Coast state have examined [capacity and congestion problems; the need to balance freight needs with environmental, social, and financial concerns; and cost issues]—and have in many cases identified regional-, metropolitan-, or facility-specific solutions—there has been no system wide examination of the needs and deficiencies in the Texas ports and waterway system as an integrated whole."

The current process of planning for state highway or rail system projects that provide access to Texas seaports varies depending upon the relationship between the TxDOT district office and local transportation entities responsible for the area in which a seaport is located. Additionally, planning processes among seaports vary. Some seaports have long-range strategic plans covering multi-year periods. Other seaports are governed by committees that make strategic decisions on a month-to-month basis without a strategic or master plan. As a result, it may be difficult for TxDOT to anticipate needs and growth in a particular area that could affect the state's transportation system.

The effectiveness of the current CIP produced by the Port Authority Advisory Committee is limited. The CIP includes projects for a two-year window and focuses on projects eligible for funding from a source that has never been capitalized. Some projects included in the CIP could be eligible for alternative methods of finance; however, these funding sources are not considered in the CIP. For instance, erosion control projects could be eligible for grants from the Coastal Erosion Program administered by the General Land Office (GLO). Projects related to rail infrastructure or road maintenance may be eligible for traditional transportation funding sources such as the Texas Mobility Fund or State Highway Fund. The Texas Emissions Reduction Plan, overseen by the Texas Commission on Environmental Quality (TCEQ), could provide funding for some seaport projects related to environmental improvements. Security-related projects may be eligible to receive funding from homeland security programs at the federal level, the Office of the Governor, or the Department of Public Safety (DPS).

The CIP is statutorily required to be distributed to the Office of the Governor, the Lieutenant Governor, and Speaker of the House of Representatives and is provided to TxDOT. Since some in-port projects historically included in the CIP may qualify for funding through programs not under TxDOT's purview, the report should be more widely distributed. Recommendation 2 would amend the Texas Transportation Code to require the CIP be distributed to GLO, TCEQ, and DPS.

According to the 2011–2012 CIP, the Port Authority Advisory Committee included all eligible projects submitted by seaports and did not prioritize them. There is no indication that the committee evaluated projects for approval or disapproval for funding, as required by statute. One explanation for this may be that the funding source for the projects, the Port Access Account Fund, is unfunded. Additionally, the requirement places committee members in a position of conflicting loyalties. Less than half of the seaports submitting projects to the CIP serve on the committee, yet the committee would be required to make decisions regarding projects submitted by all seaports.

Recommendation 3 would amend the Texas Transportation Code to remove the requirement that the Port Authority Advisory Committee prioritize projects listed in the CIP. Statute would also be amended to reformat the report so it provides information that would allow TxDOT to consider prioritizing projects in statewide transportation plans. The recommendation would amend statute so the CIP:

- is more strongly linked to the state's established transportation goals and objectives;
- identifies the critical needs that will benefit both the state transportation system and seaports; and
- covers a minimum period of five years so identified projects can be incorporated into the STIP and therefore be eligible for the maximum amount of federal funding available.

The Texas Transportation Code requires TxDOT to develop a process to identify and distinguish between transportation projects required to maintain state infrastructure and transportation projects that would improve state infrastructure. Additionally, TxDOT is required to establish criteria to prioritize transportation needs for the state that are consistent with the SLRTP. Statutorily requiring the CIP to include intermodal improvements that could be made at the state level, and requiring projects in the CIP to be classified into, at a minimum, mobility and preservation projects would aid TxDOT in meeting the statutory requirements noted previously. Other TxDOT planning documents, including the UTP and the Report on Projects for Traffic from International Trade, use mobility and preservation as project classifications. TxDOT should integrate the reformatted CIP with its other key planning and programming activities and use this when developing the state's overall transportation program. Additionally, the project list related to on-port improvements provided in the reformatted CIP would allow TxDOT to determine whether a seaport is increasing in size or capacity and the state should plan for increased traffic.

Currently, there is no consistency among seaport measurements, either within the CIP or at a state level. The CIP includes a profile of each seaport, including the seaport's:

- legal name;
- a description of the seaport's governing body;
- service area;
- cargo tonnage at seaport facilities and seaport area tonnage;
- economic value;
- principal trading partners;
- principal activities and products; and
- operating revenues and expenses.

This information is useful, but is provided inconsistently by seaports represented in the CIP. Additionally, what is included may not be comparable across seaports. For instance, some seaports quantified their economic value based on studies completed in 2006, while others used studies completed in 2008. Therefore, in addition to the discretionary information already included, standard measures that more fully describe seaport productivity should be reported for each seaport included in the CIP. Recommendation 4 would amend the Texas Transportation Code to require the Port Authority Advisory Committee, in collaboration with TxDOT, to establish specific performance measurements for seaports and definitions and the methodology for calculating these. The results of each measurement would be required to be included in the CIP. Including agreed upon measures in the CIP would allow TxDOT and other state agencies access to data that could be used for planning purposes. For instance, measures related to a seaport's principal activities and products could help TxDOT plan for road damage by indicating whether heavy vehicles are likely to travel to and from a seaport. Using standard definitions and methodologies to calculate these measures across seaports would help ensure the quality of data being used. Measures should address:

- seaport traffic (such as vessel calls) and standard measures of cargo being shipped through the seaport;
- planned on-port investments;
- freight traffic to and from the seaport;
- economic impacts from seaport activities (such as jobs resulting from port activities and tax dollars generated); and
- regional cargo and passenger forecasts.

Current committee membership is made up entirely of seaport representatives. To increase collaboration between the state's public seaports and TxDOT, Recommendation 5 would expand committee membership to include TxDOT staff with highway and rail expertise.

These changes to the CIP and committee would increase coordination between TxDOT and the state's seaports. Increased coordination would help improve the state's transportation system to meet the needs of both business and the state, enhance current processes for freight planning, and link local and state initiatives to ensure projects are better positioned for state and federal funding.

COORDINATION OF SEAPORT ACTIVITIES IN OTHER STATES

All coastal states and many states along the Great Lakes have water ports. Planning requirements for seaports vary across these states. Some states have no requirements, others have requirements of individual seaports or seaport authority associations, and others have requirements of their Department of Transportation. Florida and Mississippi have

both incorporated seaport activities into overall transportation planning at the state level.

The Florida Seaport Transportation and Economic Development Council (council) was established to create a collaborative relationship between the Florida Department of Transportation and the state's seaports. Council membership is made up of the state's 15 seaport directors and a representative from the Department of Transportation and the Department of Economic Opportunity. The Council approves project applications and selected projects are reviewed by the Governor's Office of Tourism, Trade, and Economic Development, the Florida Department of Transportation (FDOT), and the Department of Community Affairs to ensure consistency with state statutes and the state's economic development and transportation plans. The council develops the five-year mission plan known as the Florida Seaport Plan.

Additionally, the Florida Department of Transportation published the Florida System Seaport Plan in 2010, to guide the state's involvement in seaports. The plan includes a statewide vision for Florida's seaports, a description of current system conditions, and performance objectives for the system by region. These elements are all agreed upon by the state, individual seaports, and other stakeholders. At the individual seaport level, the plan also includes market projections, on-port needs, and off-port needs. Lastly, the plan includes the roles, responsibilities, and objectives of the state in relation to seaports, primarily focusing on FDOT but not exclusively. The seaport plan focuses on Florida's seaports and their connections to highway and rail networks. FDOT used the plan to integrate seaport activities with the larger state freight planning program. The purpose of this format was to

> "recognize that while Florida's ports will continue to be operated as individual businesses, there is a need for continued and increased partnership between the State and the ports to ensure the system as a whole functions at the highest possible level. …The articulation of a shared vision and future performance targets for the system as a whole provides the ports with useful guideposts as they fulfill their mission, as well as helping them better align with larger statewide strategic system objectives."

In 2000, the Comprehensive Assessment of the Ports of Mississippi was published. This assessment provided an overview of each seaport's attributes, needs, markets served, and identified capital budget projects. Since 2000, seaport planning has been incorporated into the Mississippi Unified Long-Range Transportation Infrastructure Plan (MULTIPLAN), Mississippi's long-range transportation planning document. The current MULTIPLAN looks forward as far as 2035, and is re-evaluated every five years. The plan includes sections focusing on highways and bridges, freight and passenger rail, transit, intelligent transportation systems, seaports and waterways, bicycle and pedestrians, and airports.

The seaports and waterways section provides:

- an overview of waterborne freight shipment trends, seaport facilities, improvement needs, and economic impacts;
- infrastructure and accessibility characteristics, cargo profiles, and planned improvements of each seaport; and
- cost estimates and planned improvements at the state's public seaports.

The plan has a listing of seaport needs. A cost estimate is included for each listing identified and the needs are divided by project type such as channel issues, rail and road access, and seaport facilities. Additionally, projects are classified into one of the following needs categories: preservation, modernization, or expansion projects. Implementing similar processes to the planning models in other states would help Texas better plan for changes and growth in port operations.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations would not have a fiscal impact. The Port Authority Advisory Committee is an established committee and expansion of the committee as well as its responsibilities regarding the CIP can be implemented using existing resources.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

AMEND SUPERVISORY REQUIREMENTS OF DELEGATED PRESCRIPTIVE AUTHORITY

Mid-level healthcare practitioners, including nurse practitioners and physician assistants, are educated to provide primary and acute care, but states use varying models to regulate these practitioners. In Texas, these providers must have their ability to diagnose and prescribe delegated to them by a physician, a process that has different administrative and supervisory requirements depending on the practice site. Compliance with these administrative and supervisory responsibilities is not audited or verified by any state or local authority.

Amending statute to simplify these regulations would allow physicians to hire and supervise mid-level healthcare providers according to the needs of their practice and the experience of the provider. It would not result in independent practice for these practitioners. These changes would standardize the administrative expectations across the state and help maintain a primary care workforce in areas that are already vulnerable to physician shortages.

FACTS AND FINDINGS

- ♦ Texas is unique among states in that its requirements of or limitations on a physician's ability to delegate prescriptive authority change depending on the practice site.
- ♦ Multiple studies, published in both medical and nursing journals, have found that states requiring more physician oversight of advanced practice nurses and physician assistants do not have lower rates of malpractice or medication errors than other states.
- ♦ Approximately 5.4 million people live in one of the state's 353 federally designated primary care health professional shortage areas.
- ♦ Nurse practitioners and physician assistants are being educated, trained, and licensed at a faster rate than primary care physicians.

CONCERNS

- ♦ At certain practice sites, a delegating physician is required to be on-site either on a set schedule or a proportion of time the clinic is open. These statutory provisions may limit access to routine care or inhibit innovation in care delivery, especially in rural and shortage areas.
- ♦ Different limitations and supervisory requirements for alternate and medically underserved sites can be administratively onerous for providers in rural areas and do not result in improved patient safety or healthcare delivery.
- ♦ Texas is one of a minority of states that restrict a mid-level provider's ability to prescribe controlled substances when it is within their scope of practice to do so.
- ♦ Under current law, if a delegating physician were to retire or become incapacitated, any mid-level provider they have delegated authority to would no longer have a valid prescriptive authority in the state.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Amend statute to eliminate the chart audit, on-site requirements, and distance limitations for physicians delegating to mid-level providers at alternate practice sites and sites serving medically underserved populations and add a requirement that physicians delegating to mid-level practitioners at those sites establish written protocols that would make the oversight responsibilities at those sites more aligned with the statutory requirements of delegating at primary practice sites.
- ♦ **Recommendation 2:** Amend statute to remove the limit on delegation in any area designated as a primary care health professional shortage area.
- ♦ **Recommendation 3:** Amend statute to authorize advanced practice nurses and physician assistants to prescribe Schedule II Controlled Substances with physician supervision.
- ♦ **Recommendation 4:** Amend statute to provide a grace period during which a physician assistants or advanced practice nurse to whom a physician has delegated prescriptive authority would be authorized to continue prescribing if their delegating physician became incapacitated.

DISCUSSION

Mid-level healthcare providers include both advanced practice registered nurses (APNs) and physician assistants (PAs). APNs comprise four types of providers: nurse practitioners (NPs), nurse midwives, clinical nurse specialists, and nurse anesthetists. In Texas, approximately 60 percent of APNs are NPs. NPs can provide a range of healthcare services that emphasize prevention of illness and health maintenance. Their practice focuses on a specific population (such as adult, family, pediatric, gerontology, or women's health). PAs also provide a range of healthcare services. Part of their training includes clinical rotations through different fields (such as family medicine, pediatrics, emergency medicine, geriatrics, and obstetrics and gynecology).

The PA and NP professions were each developed in the mid-1960s in response to a shortage and uneven distribution of primary care physicians nationwide. Most people who come to each profession do so with some experience in healthcare. Becoming an APN requires having a bachelor's degree in nursing, as well as completing the required clinical hours and passing the national certification exam to be a registered nurse. APN education programs are accredited and housed within nationally accredited graduate programs. They can be master's or doctoral level and must include at least a 500-hour practicum per population focus area. Following completion of an education program, an APN must pass a national certification exam.

Most PA programs require a bachelor's degree, though admissions requirements vary program to program. There are 165 PA programs accredited by the Accreditation Review Commission on Education for the Physician Assistant. These programs are usually housed within allied health education programs, academic health centers, medical schools, or four-year colleges. PA education lasts about two years and includes clinical rotations in several scopes of practice (such as internal medicine, pediatrics, geriatric medicine, obstetrics and gynecology).

APNs and PAs are educated and trained according to national standards to provide basic levels of healthcare within defined scopes of practice. Therefore, both types of providers refer patients who need specialized care to either general practice or specialty physicians.

STATE-LEVEL REGULATIONS

Texas is unique among states in that its regulations, which require a physician to delegate authority to diagnose and prescribe to a mid-level provider, vary depending on the practice site:

- A physician practicing at their primary practice site may delegate to up to four full-time equivalent (FTE) mid-level providers.
- A physician who also practices at an alternate site is limited to delegating to up to four FTEs between their primary and alternate locations. The physician's alternate site must also be within 75 miles of either their home or primary site and offer the same type of healthcare service as the primary location. The physician is also required to be on site 10 percent of the operating hours of the site and to review 10 percent of each midlevel provider's charts.
- A physician practicing at a site serving a medically underserved population (MUP) or population may delegate authority to an unlimited number of mid-level providers. The physician is limited to delegating at three such sites with a combined 150 operating hours per week. This physician must also be at each MUP site every 10 days and audit 10 percent of each mid-level provider's charts.
- Physicians may also delegate at hospitals and long-term care facilities. Physicians delegating at hospitals may delegate to as many mid-level providers as they feel is necessary, but they may delegate at one hospital. A medical director at a long-term care facility may delegate authority to up to four mid-level providers at up to two facilities.

Prescriptive authority for APNs and PAs is totally dependent on having a supervising physician. The APN or PA loses their prescriptive authority if their delegating physician becomes incapacitated, dies, or suddenly retires without having an alternate supervising physician. This situation could leave patients potentially without care.

HISTORY OF TEXAS' DELEGATED MODEL

The state's first expansion of prescriptive authority was in 1989. The Seventy-first Legislature, Regular Session, 1989, passed legislation to address a shortage of healthcare providers in the rural parts of the state. One of its provisions allowed physicians practicing at sites serving a medically underserved population to delegate prescriptive authority to APNs and PAs. Physicians were required to be on-site each week, receive daily status reports, and be available for direct telecommunication for consultations, assistance with

emergencies, or referrals. During the Seventy-fifth Legislature, Regular Session, 1997, legislation was passed that changed the on-site requirement from weekly to every 10 business days. Texas Medical Board rules also require the physician to review and countersign 10 percent of each delegated provider's charts.

The next expansion of prescriptive authority came when the Seventy-fourth Legislature, Regular Session, 1995, passed legislation that allowed physicians to delegate to PAs and APNs at primary practice sites or facility-based sites. Delegation at primary sites was limited to three of these mid-level providers or their full-time equivalents.

Legislation passed by the Seventy-seventh Legislature, Regular Session, 2001, added alternate practice sites to the list of places where a physician could delegate authority. The legislation required a site to be within 60 miles of the physician's primary practice site. The physician was limited to delegating to 3 FTEs between their primary and alternate sites. The physician also had to be on-site at the alternate location at least 20 percent of the time and review 10 percent of each delegated provider's charts. The Eighty-first Legislature, Regular Session, 2009, changed the limit on delegating at primary and alternate sites from three to four FTEs, expanded the distance between a primary and alternate site to 75 miles and decreased, from 20 percent to 10 percent, the proportion of time a physician was required to be on-site. The physician still had to review 10 percent of the delegated provider's charts.

At alternate and MUP sites, state law limits the number of providers to whom a physician may delegate, has certain requirements for the physician to be on site, and requires the physician to audit a percentage of charts of providers to whom they delegate authority. The benefit of these requirements is not clear. The audit of provider charts is retrospective and unlikely to reveal a medication error or scope of practice violation before either of those things would have been discovered another way (such as by a pharmacist or patient complaint). Neither a physician's presence at alternate and MUP sites nor the results of the chart audit at those sites are reported to the Texas Medical Board or the Texas Board of Nursing, each of whom investigate PAs and APNs, respectively, on a complaint-driven basis.

The chart review and on-site requirements are also administrative burdens to the extent that they add to whatever oversight, training, or evaluation the delegating physician and/or practice administrator may already have in place for both mid-level providers and employees without prescriptive authority (such as other types of nurses).

REGULATIONS IN OTHER STATES

Even though PAs and APNs are educated and trained according to national standards, state-level regulations vary.

Eighteen states and the District of Columbia allow NPs to diagnose and prescribe within their scope of practice without physician involvement. Twenty-two states require a collaborative practice agreement between an NP and physician for the sake of referrals or consultation, but do not require the physician to supervise in any specific way. Ten states, including Texas, put specific limits or impose requirements on physicians who either employ or delegate to mid-level providers.

Twenty-five states require a physician who supervises a PA to practice on-site with them at least weekly, monthly, or some proportion of the time the PA is on-site; 25 other states have no specific requirements for a physician to be on-site when a PA is practicing.

Thirty-five states and the District of Columbia allow PAs to write prescriptions for Schedule II Controlled Substances at least under limited circumstances; the remaining states, including Texas, prohibit them from prescribing any Schedule II Controlled Substances. Forty-one states and the District of Columbia allow NPs to prescribe Schedule IIs at least under limited circumstances.

Multiple studies, published in both medical and nursing journals, have reported that states requiring more physician oversight of APNs and PAs do not have lower rates of malpractice or medication errors than other states.

In letters to Texas and other states with restrictive regulations on physicians and mid-level providers, the Federal Trade Commission (FTC) has cautioned that such restrictions limit patients' access to healthcare and raise prices. The FTC suggests that reducing the administrative requirement of delegated prescriptive authority would lower administrative costs for clinics and physician offices, reduce barriers to entry in the healthcare market, spur innovation in healthcare delivery, and increase competition to provide basic services. For instance, the requirements may discourage innovations like limited service centers (LSCs). These clinics are typically staffed with a NP and provide a narrow range of primary and preventative care services, generally to uninsured people, are accessible in a variety of locations (such as malls, grocery stores, and pharmacies) and are open non-traditional hours.

RECENT REGULATORY CHANGES IN OTHER STATES

Since 2010, five states have made significant changes to how the regulate NPs. Three of these states (Illinois, North Dakota, and Vermont) have made these changes since the Eighty-second Texas Legislative Session.

- Nurse practitioners in Maine have had independent practice authority following two years of working under the supervision of a physician since 1994. As of 2010, Maine allows nurse practitioners to complete their two years of supervised practice with another nurse practitioner. The reason for the change was a shortage of physicians in the rural parts of the state;
- Maryland now allows NPs to practice under a collaboratively developed practice agreement with a physician. NPs may also lead Medical Homes in the Maryland Health Plan;
- Illinois removed its requirements that NPs meet face-to-face with their collaborating physicians. The state's Nurse Practice Act was also revised to allow NPs to prescribe some Schedule II Controlled Substances;
- Vermont now requires an NP to work under a collaborative practice agreement with a physician or NP in the same focus area for two years before having completely autonomous practice within their scope of practice; and
- North Dakota repealed its requirement that an APN work within a collaborative practice agreement with a physician. They now practice without formal physician involvement.

PRIMARY CARE SUPPLY ISSUES

Texas, like the rest of the U.S., is experiencing a current and projected shortage of primary care physicians. Approximately 5.4 million people live in one of the state's 353 federally designated primary care health professional shortage areas (which are areas of the state that have a low primary-care-provider-to-population ratio).

Also like the rest of the country, Texas has seen sharp increase in the number of people joining the mid-level healthcare professions. While the supply of primary care physicians in Texas has slightly decreased in the last decade, the supply of NPs and PAs has quickly increased. In 2000, the state had 70.1 primary care physicians per 100,000 population. In 2011, the ratio was 69.5 primary care physicians per 100,000. The ratio of NPs per 100,000 increased from 12.4 in 2000 to 25.8 in 2011. PAs per 100,000 population grew from 10.4 to 20.8. The share of the primary care workforce consisting of NPs, nurse midwives, and PAs increased from 27.1 percent in 2001 to 40.6 percent in 2011. **Figure 1** shows the change in supply of potential primary care providers and the Texas population from 2001 to 2011.

FIGURE 1
CHANGE IN SUPPLY OF PRIMARY CARE PROVIDERS AND TEXAS POPULATION, 2001 TO 2011

PROVIDER TYPE	2001	2011	PERCENTAGE CHANGE
Primary Care Physician	14,437	17,996	24.7%
Nurse Practitioner	2,804	6,676	138.0%
Physician Assistant	2,319	4,818	107.8%
Nurse Midwife	254	268	5.5%
Texas Population	21.0 million	25.9 million	25.1%

Sources: Legislative Budget Board; Texas Department of State Health Services.

A 2002 report by the Medicare Payment Advisory Commission (Medpac), examined Medicare claims data on the types of services provided by non-physician primary care providers (including NPs, PAs, and certified nurse midwives (CNMs)). Analyzing approximately 8.5 million claims for evaluation and management services (which are coded differently to communicate the level of medical complexity involved in the patient visit) Medpac found that the majority of services provided by NPs, PAs, and CNMs were of low to moderate complexity. **Figure 2** shows Medpac's findings on complexity level of services by provider type.

FIGURE 2
LEVEL OF COMPLEXITY OF MEDICARE EVALUATION AND MANAGEMENT SERVICES BY TYPE OF PRACTITIONER, 2000

PRACTITIONER	LOW COMPLEXITY	MODERATE COMPLEXITY	HIGH COMPLEXITY
Primary Care Physician	55%	34%	11%
Nurse Practitioner	57%	35%	9%
Physician Assistant	59%	34%	7%
Certified Nurse Midwife	77%	19%	4%

Source: Medicare Payment Advisory Commission.

REFORMING DELEGATED PRESCRIPTIVE AUTHORITY LIMITATIONS AND REQUIREMENTS

Reforming the state's requirements for delegating prescriptive authority would provide consistency across practice sites and alleviate some administrative burden on physicians who delegate at alternate and MUP sites. Diagnosing and prescribing would remain delegated medical acts requiring physician involvement, but the physician would supervise those services in a way that reflected both their best medical judgment and the experience and needs of the mid-level practitioner.

Recommendation 1 would amend the Texas Occupations Code to replace the requirements for chart audits, on-site supervision, and distance limitations for physicians delegating authority at alternate and MUP sites with a single requirement. The new requirement would mandate delegating physicians at those sites to establish written protocols that designate the evaluation and quality assurance measures necessary to manage the care of patients. This process would make the oversight responsibilities at those sites more aligned with the statutory requirements of delegating at primary practice sites, which specify only that a physician's supervision conform to what a reasonable, prudent physician would find consistent with sound medical judgment but may vary with the education and experience of the particular advanced practice nurse or physician assistant. This recommendation would allow physicians more discretion in how they allocate their time between sites, and allow them to supervise or be available for consultations as appropriate via phone, text message, or video conference.

Recommendation 2 would amend the Texas Occupations Code to remove the limit on delegation in any area designated as a primary care health professional shortage area. Removing the limit on how many mid-level providers a physician may delegate to in a health professional shortage area would help maintain a primary care workforce in areas of the state that are already vulnerable to shortages.

Recommendation 3 would amend the Texas Occupations Code to authorize physicians to delegate specific Schedule II Controlled Substance to PAs and APNs. This authorization would allow those providers to appropriately treat those conditions that are within their scopes of practice while also reserving for the physician some supervision over their use.

Recommendation 4 would amend the Texas Occupations Code to authorize a six-month grace period during which a PA or APRN may continue to practice if their delegating physician suddenly dies, retires, or is incapacitated. This recommendation would likewise help protect the workforce in rural and shortage areas of the state.

None of these changes would result in independent practice for APNs or PAs. Physicians would still delegate prescriptive authority, but could adjust their delegation to the needs of their patients and their supervision to the education and experience of the PA or APN. Physicians may choose to maintain the current supervision levels and tasks required by statute.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations would have no fiscal impact but could result in administrative cost savings for healthcare provider offices and help maintain a primary care workforce in areas of the state with provider shortages.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

MAXIMIZE THE USE OF DENTAL HYGIENISTS TO INCREASE MEDICAID-ELIGIBLE CHILDREN'S ACCESS TO PREVENTIVE DENTAL CARE

Children with Medicaid coverage receive medical and dental services through the Early and Periodic Screening, Diagnosis, and Treatment benefit. In Texas, this benefit is known as the Texas Health Steps program. Program services are intended to screen, diagnose, and treat eligible children at early, regular intervals to avoid or minimize childhood illness. In fiscal year 2011, 2.2 million children received some preventive and treatment dental services under the Texas Health Steps program. However, 1.4 million children eligible to receive dental services did not receive any type of dental care in fiscal year 2011.

Access to dental providers continues to be an issue among Medicaid-eligible children living in rural and border areas of Texas. Residents of rural and border counties are less likely to be served by dental providers and dental providers willing to accept Medicaid insurance. In fiscal year 2011, 85 counties had no dentists enrolled in the Texas Health Steps program.

Dental hygienists are a growing component of the dental workforce. Other states have lifted restrictions on the settings where these licensed oral health professionals can practice as a way to increase the supply of dental providers serving children and other vulnerable populations. In Texas, dental hygienists are allowed to practice with delegated authority in nursing facilities, school-based health centers, and community health centers. Authorizing dental hygienists to perform delegated services in educational settings would increase access to preventive dental care for children and would help avoid Medicaid costs associated with untreated oral disease.

FACTS AND FINDINGS

- ♦ Despite being preventable, tooth decay is the most common chronic infectious disease among U.S. children. Untreated tooth decay can affect speech, learning, nutrition, growth and function, social development, and quality of life. Failed prevention is costly to the healthcare system as children who lack access to regular preventive care may seek treatment in emergency departments at a much higher cost.
- ♦ In fiscal year 2011, approximately 61 percent of all children enrolled in the Texas Health Steps program received at least one dental service. This percentage is greater than the national average 38.1 percent.
- ♦ The statewide supply of general dentists and dental hygienists each slightly increased from 2000 to 2011, from 36.5 to 38.3 per 100,000 and 34.7 to 39.5 per 100,000, respectively. However, the supply of dental care providers decreased in 122, mostly non-metropolitan, counties.
- ♦ As of October 2012, Texas had 229 dental health professional shortage areas, 96 of which were designated as whole county shortage areas.
- ♦ Dentists may delegate services to a licensed dental hygienist if the supervising dentist examines the patient at the time the service is provided or within the previous 12 months, and the dental hygienist does not diagnose, prescribe treatment or medication, or perform an irreversible procedure.
- ♦ Statute provides an exception to the requirement that the supervising dentist examine the patient at the time of service or within the previous 12 months when the dental hygienist has at least two years experience, and the service is provided in a nursing facility or a school based or community health center.

CONCERNS

- ♦ Of all the children eligible for services under the Texas Health Steps program in fiscal year 2011, less than one-half received a preventive dental service necessary for the early detection of oral disease.
- ♦ Although the dental provider to population ratio is increasing, dental providers are unequally distributed across the state. Texans living in rural and border areas have the lowest supply of dental providers and are less likely to have access to dental care.
- ♦ Even though more than one-half of all dental providers are enrolled in the Texas Health Steps program, an increasing number of counties do not have a Texas Health Steps dental provider serving their community. In fiscal year 2011, 85 counties had no dentists enrolled in the Texas Health Steps program.

- Dental hygienists are not authorized to perform preventive services at schools and Head Start program sites without a supervising dentist having examined the patient in the preceding 12 months.

RECOMMENDATION

- **Recommendation 1:** Amend statute to include pre-schools, K–12 schools, and Head Start programs in the list of facilities excepted from the requirement that the supervising dentist must examine the patient within the preceding twelve months.

DISCUSSION

Despite being highly preventable, tooth decay is the most prevalent chronic infectious disease among U.S. children. If left untreated, tooth decay can adversely affect speech, learning, nutrition, growth and function, social development, and quality of life. According to 2008 data by the National Center for Chronic Disease Prevention and Health Promotion, 73 percent of Texas third graders experience tooth decay and 43 percent of third graders have untreated tooth decay. Despite the effectiveness of dental sealants in preventing tooth decay, only 34 percent of these students have one or more sealants on their permanent first molar teeth. **Figure 1** shows that the incidence of tooth decay among Texas children is significantly higher than the U.S. average and well below the Healthy People 2020 oral health objectives. Healthy People 2020 is a comprehensive health promotion and disease prevention program that seeks to improve the health of all Americans. These objectives were established as benchmarks of oral health for all states and territories by the U.S. Department of Health and Human Services.

The prevalence of tooth decay is not uniformly distributed in the U.S. or in Texas. Historically, the incidence of oral disease has been much higher among low-income children, even for children covered by public insurance programs such as Medicaid and the Children's Health Insurance Program (CHIP) than for children who are privately insured. Research shows that low-income children are more likely to experience tooth decay and poorer oral health outcomes, have fewer dental visits, and receive fewer protective dental sealants. Although dental services are available for children enrolled in Medicaid, many children experience a high incidence of dental problems due to inadequate access to dental care and preventive dental services. Without access to preventive dental services, dental care for children is postponed until symptoms, such as toothache and tooth abscesses, become so acute that treatment is sought in hospital emergency departments at a much higher cost. A study by the South Carolina Dental Association estimates that treating a patient with an abscessed tooth in an emergency room, for example, would cost Medicaid twice as much as it would if treated in a dental office.

Many factors affect access to dental care including dentist shortages and maldistribution of dentists, especially of those accepting Medicaid patients. Presence of oral disease and dental care utilization are common indicators used to determine individuals' access to professional services.

Medicaid's Early and Periodic Screening, Diagnosis, and Treatment (EPSDT) benefit provides medical and dental prevention and treatment services for low-income children under age 21. Every state Medicaid must offer the EPSDT benefit and, in Texas, EPSDT is known as Texas Health Steps (THSteps). The program provides services that are intended to screen, diagnose, and treat eligible children at early, regular intervals to avoid or minimize childhood illness. THSteps provides periodic dental checkups and preventive care for children age six months to age 20. The intervals between dental checkups depend on the child's age and risk for dental disease, but the program supports the initiative to reach

FIGURE 1
ORAL HEALTH OF CHILDREN AND ADOLESCENTS IN TEXAS AND THE U.S. 2008 AND 2020 TARGET

INDICATOR	AGE	TEXAS	U.S.	2020 TARGET*
Tooth decay experience	Young children (2 to 4)	45%	23 %	30.0%
	Children (6 to 8)	68%	50%	49.0%
	Adolescents (15)	Not available	59%	48.3%
Untreated dental decay	Young children (2 to 4)	29%	20%	21.4%
	Children (6 to 8)	44%	26%	25.9%
	Adolescents (15)	Not available	16%	15.3%

*U.S. Department of Health and Human Services target.
Sources: Texas Department of State Health Services; U.S. Department of Health and Human Services.

children with preventive oral health screening and care at the earliest appropriate age (six months). THSteps requires dental screenings at 6, 12, 18 and 30 months of age and then annually until a child is age 21.

In fiscal year 2011, 2.2 million of the 3.5 million children eligible for THSteps received any dental service, an increase of approximately 730,000 more than fiscal year 2008. According to a 2010 report by the Centers for Medicare and Medicaid Services, the increase in the utilization of children's dental services is the result of a combination of initiatives Texas has implemented such as increasing the reimbursement rate for dental services and the First Dental Home Initiative. The state implemented both initiatives as a result of a class action lawsuit filed against the state related to deficiencies in the Texas Medicaid program. Of the children who received dental care through THSteps, 80 percent received a preventive dental service in fiscal year 2011. Preventive services include dental cleanings, application of topical fluoride, sealants, maintenance of space, and oral health education. Dental sealants, which prevent tooth decay from developing in the pits and fissures of the teeth, were not used as often as other preventive services such as dental cleanings and topical fluoride. Similarly, not all children who received dental services visited the dentist at the same rate. For example, according to the THSteps periodicity schedule, children ages 1 to 2 are mandated to have at least three dental visits (at 12, 18, and 30 months), yet this group had the second lowest number of dental visits among all children in fiscal year 2011.

In addition to age variation, the number of dental visits also varied by geographic location. In 2011, the Texas Health and Human Services Commission (HHSC) issued a report on service utilization of checkups. HHSC reported that THSteps clients age one and older, living in 32 counties or county clusters, had dental checkups at a rate below the state average in fiscal year 2010. Although Texas has significantly increased the number of children receiving at least one dental visit per year, many children are not receiving appropriate dental care due to their geographic location. An even higher number of Medicaid-eligible children in Texas, 1.4 million, are not receiving any dental care at all.

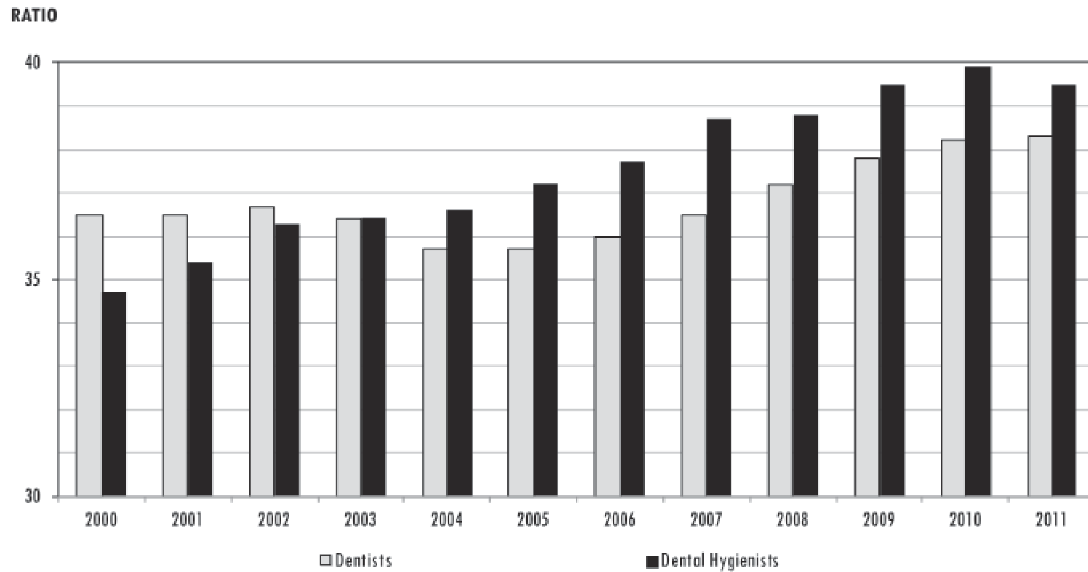
BARRIERS TO DENTAL CARE

Several barriers negatively affect access to dental care in Texas. As of October 2012, 2.3 million Texans lived in one of the 229 areas designated as having a shortage of dental health professionals. Health Professional Shortage Areas (HPSAs) are designated by the U.S. Department of Health and Human Services as having shortages of medical, mental, and dental providers. HPSA designations can be based on geography (e.g., county or service area), demographic group (e.g., low-income population) or institutions (e.g., comprehensive health center, federally qualified health center or other public facility). Ninety-six Texas counties were designated whole county dental HPSAs, meaning these counties experienced a shortage of dentists. Fifty-six percent, of all Texas counties have at least one or more types of dental HPSAs. According to the U.S. Department of Health and Human Services, in order to eliminate all 229 HPSA designations, or to achieve an optimal ratio of 3,000 residents to one dental practitioner, Texas would need 692 additional dentists.

The dentist-to-population ratio is helpful in determining whether there are a sufficient number of dental providers to meet the demands of the state as whole and to estimate their geographic distribution. As of 2011, Texas had 9,909 general dentists, or 38.3 dentists per 100,000 population and 10,225 dental hygienists, or 39.5 dental hygienists per 100,000 population. In Texas, the supply of general dentists has fluctuated slightly more than the supply of the past decade despite the increase of the general population. Conversely, the supply of dental hygienists has been greater than of dentists since fiscal year 2004. **Figure 2** shows the supply of dental providers in the state since fiscal year 2000.

Despite the increase in the dentist-to-population ratio, 46 counties did not have dentists in fiscal year 2011, and 57 counties experienced a decrease in the number of dentists from 2002 to 2011. Most of the 46 counties without dentists were located in West Texas, the Panhandle, and South Texas which historically have had low supply ratios. Based on 2011 dentist-to-population ratios for all Texas counties, dental providers were most concentrated in urban non-border areas and least concentrated in rural border areas, with the highest concentration of dentists in Central Texas. **Figure 3** shows the dentist-to-population ratios by area. Because dental hygienists usually practice with a supervising dentist, their geographic distribution is very similar to that of dentists. This suggests that while workforce numbers may be adequate, the maldistribution of the dental workforce represents a greater concern. Geographic dispersion is a long-recognized challenge and is attributed in part to the ability of a dentist to support private practices in rural areas because of population size and income. Thus, historically, people living in rural areas are less likely to receive dental care in comparison

FIGURE 2
GENERAL DENTISTS AND DENTAL HYGIENISTS PER 100,000 POPULATION
FISCAL YEARS 2000 TO 2011



Sources: Texas State Board of Dental Examiners; Texas Department of State Health Services.

FIGURE 3
DENTISTS PER 100,000 POPULATION BY AREA
FISCAL YEAR 2011

AREA	RATIO
Urban non-border areas	42.6
Rural non-border areas	24.9
Urban border areas	20.7
Rural border areas	12.8

Note: Border counties include Brewster, Brooks, Cameron, Crockett, Culberson, Dimmit, Duval, Edwards, El Paso, Frio, Hidalgo, Hudspeth, Jeff Davis, Jim Hogg, Kennedy, Kinney, La Salle, McMullen, Maverick, Pecos, Presidio, Real, Reeves, Starr, Sutton, Terrell, Uvalde, Val Verde, Webb, Willacy, Zapata and Zavala.
Source: Health and Human Services Commission.

to their counterparts in urban areas. In Texas, the dentist-to-population ratio for urban areas is significantly higher than in rural areas, a gap that has been widening over the past decades. Texans living in border counties, both urban and rural, are also likely to experience limited access to dental care. Overall, maldistribution of dental providers exists between rural and urban areas as well as border and non-border areas.

Maldistribution of dental providers accepting children covered by Medicaid is another limiting factor for low-income children's access to dental care. In fiscal year 2011, there were 5,282 general dentists enrolled in the THSteps program. Fifty-three percent of the 9,909 general dentists participated in the program in fiscal year 2011. Although more than one-half of all general dentists are enrolled in the program, an increasing number of counties do not have a THSteps dental provider. In fiscal year 2011, there were 85 counties that had no dentists accepting Medicaid patients. The majority of THSteps dental providers were located in Harris, Dallas, Tarrant, Bexar and Travis counties, which combined, accounted for more than one-half of all program providers during fiscal year 2011. Fifty-nine counties lost at least one dental provider from fiscal years 2007 to 2011. For at least 25 counties, losing a THSteps dental provider meant losing all dental providers serving Medicaid-eligible children living in the county.

THE ROLE OF DENTAL HYGIENISTS

Dental hygienists are licensed oral health professionals who focus on prevention and treatment of oral diseases. The entry-level educational requirement for dental hygienists is an associate's degree from a school recognized and accredited by the Commission on Dental Accreditation of the American Dental Association. To obtain licensure, dental hygienists must pass a national written board exam as well as a clinical exam. Services provided by dental hygienists include:

- patient screening procedures such as assessment of oral health conditions, review of the health history,

oral cancer screening, head and neck inspection, dental charting and taking blood pressure and pulse;

- removing calculus and plaque (hard and soft deposits) from all surfaces of the teeth;
- taking and developing dental x-rays;
- applying pit and fissure sealants;
- monitoring patients receiving nitrous oxide or oxygen inhalation conscious sedation;
- teaching patients appropriate oral hygiene strategies to maintain oral health (e.g., tooth brushing, flossing and nutritional counseling);
- making impressions of patients' teeth for study casts (models of teeth used by dentists to evaluate patient treatment needs);
- counseling patients about good nutrition and its impact on oral health; and
- performing documentation and office management activities.

In Texas, dental hygienists are required to practice dental hygiene under the supervision of a licensed dentist in either a dental office or an alternate setting. Alternate settings include nursing homes, patient's homes, schools, hospitals, state institutions, public health clinics, and other institutions under the supervision of a licensed dentist. Dentists may delegate duties to dental hygienists who are under the supervision and responsibility of the dentist. Dentists are not required to be on the premises when the dental hygienist performs the delegated task. For a dentist to delegate duties to a dental hygienist, the following conditions must be met:

- the dental hygienist is licensed to perform the task,
- the supervising dentist examines the patient at the time the service is performed or within the past 12 calendar months, and
- the dental hygienist does not diagnose a dental disease, prescribe a treatment, or perform a procedure that is irreversible or involves the intentional cutting of soft or hard tissue.

A dentist may authorize a dental hygienist to perform a procedure on patients whom the dentist has not seen within the past 12 calendar months outside the dental office or an alternate setting. For a dentist to provide authorization without seeing a patient first, the dental hygienist must have at least two years of experience and see the patients in nursing homes, school-based health centers or community health centers.

Dental hygienists may only perform delegated tasks or procedures on patients at these three sites and their delegated authority lasts six months. Dental hygienists are prohibited from providing a second set of services until the patient has been seen by either a dentist who delegated the authority to a dental hygienist, or by a dentist to whom the patient was referred. In addition, dental hygienists are required to refer patients to a licensed dentist after the completion of a procedure.

Scope of practice and supervision requirements for the dental hygienist profession varies greatly from state to state. In some states, including California, Colorado and Kansas, dental hygienists may perform dental hygiene assessments and provide dental hygiene services without the prior authorization or presence of a dentist, and are authorized to maintain a provider-patient relationship. As of June 2010, 32 states, including Texas, permit some form of direct access to dental hygienists.

DENTAL CARE IN EDUCATIONAL SETTINGS

School-based health centers (SBHCs) were developed in the 1970s to provide basic healthcare services in elementary and secondary schools. SBHCs are usually located on school campuses and have relationships with hospitals and other providers to accept referrals for complex health problems or to provide services to students when the SBHC is closed. SBHCs are convenient care locations for children and parents because they eliminate the need for transportation, parent time off, and missed school. In Texas, there are 85 SBHCs across the state but only 12 offer dental services.

Preventive dental services provided in educational facilities are also delivered through school-based or school-linked programs, which have been designed to reach children outside of traditional healthcare settings. School-based programs are conducted entirely in schools, where local dentists may provide services on site, while school-linked programs are conducted both in schools and clinic settings outside of schools. Examples of school-based or school-linked programs include dental sealant and fluoride varnish programs. These programs typically work with schools and school districts with high proportions of low-income children for delivering preventive dental interventions because these children are at a greater risk of tooth decay and are least likely to access dental care in a private setting. These schools and

schools districts are identified based on the number of enrolled children participating in the free- or reduced-price school lunch program. During the 2010–11 school year, approximately 3 million children in Texas qualified for the free- or reduced-price school lunch program.

Head Start programs are also ideal settings for delivering oral health services to children, since the programs' participants include a higher percentage of low-income infants and young children. Head Start is a federal program administered by the Office of Head Start (OHS), Administration for Children and Families (ACF), and was established to improve the school readiness of children ages 3 to 5 from families with low incomes. In Texas, there are 82,000 children enrolled in Head Start programs. Head Start programs must meet federal requirements and performance measures related to health, including dental assessments and dental care. Specifically, Head Start programs are required to determine whether a child has received age-appropriate preventive dental care within 90 days of the child entering the program. If a child has not received appropriate preventive care, the program must help parents arrange for the child to receive it. Appropriate care received by children in Head Start programs is determined by the THSteps periodicity schedule. Head Start programs must also obtain or arrange for testing, examination, and treatment for children with known or suspected dental problems, and develop and implement a follow-up plan for any problems identified. It is a challenge for Head Start children and low-income children in general to have access to a dental provider. Nationwide, Head Start staff and parents report that the number-one issue affecting children enrolled in Head Start is lack of access to oral health services.

To increase the supply of dental providers and ensure dental access for low-income children living in underserved areas, various states allow non-dental providers, such as dental hygienists, to perform basic preventive oral services in settings such as schools, community developmental disabilities organizations, and Head Start programs. Many states have allowed dental hygienists to practice in these settings to fully maximize dental hygienists' education and training, which is primarily focused on preventive dental care.

In Texas, dental hygienists are already permitted to perform certain delegated procedures at SBHCs. Given that many Texas children still lack access to dental care, allowing dental hygienists to perform the same procedures in educational settings such as schools and Head Start programs, as those authorized to be provided in SBHCs, would create an additional point of entry into the healthcare system and allow more children to receive basic dental screenings. Dental hygienists would still have to refer patients to dentists, and by doing so dental hygienists would assist children in finding permanent dental homes.

Recommendation 1 would amend the Texas Occupations Code, Section 262.1515, to include pre-schools, K–12 schools, and Head Start programs in the list of facilities excepted from the requirement that the supervising dentist must examine the patient within the preceding twelve months. This would allow dental hygienists to perform those services currently permitted in SBHCs to be performed in additional educational settings, without making any changes to the level of supervision required.

FISCAL IMPACT OF THE RECOMMENDATIONS

Recommendation 1 has no fiscal impact, but could result in increased access to preventive dental care. Increased access to preventive dental care would result in cost avoidance to the state of more expensive dental procedures as a result of untreated oral disease. This preventative care could also decrease the use of emergency rooms for treatment services related to untreated dental conditions.

The introduced 2014–15 General Appropriations Bill does not include any adjustment as a result of this recommendation.

STRENGTHEN THE BOARD OF PROFESSIONAL GEOSCIENTISTS' ABILITY TO INVESTIGATE VIOLATIONS

The Texas Board of Professional Geoscientists was established in 2001 and is charged with enforcing the Texas Geoscience Practice Act. Pursuant to this act, the agency licenses professional geoscientists performing work for the public and investigates complaints against professional geoscientists. Services performed by licensed geoscientists directly affect the public in activities such as roadway construction, groundwater planning, and abandoned site cleanup. A geoscientist's error could, for example, result in the collapse of a bridge if the soil and rock it is built on is unstable. Many of the agency's regulatory responsibilities relating to professional geoscientists overlap with geoscientific activities carried out by other state agencies.

Simplifying the complaint filing process, clarifying statutory requirements for filing a complaint, requiring state agencies to notify the Texas Board of Professional Geoscientists of potential violations of the Texas Geoscience Practice Act, and requiring the agency to train appropriate state employees on when and how to file a complaint would strengthen the agency's ability to enforce statutory requirements for professional geoscientists and investigate complaints.

CONCERNS

- ♦ The process for filing a complaint against a professional geoscientist is more difficult than comparable processes at other regulatory agencies. The Board of Professional Geoscientists' complaint form requires the signature and seal of a notary public and the complaint submission process is not described on their website as clearly as it typically is on other state regulatory agency websites.
- ♦ At least one agency overseeing activities requiring a licensed geoscientist has developed an internal complaint evaluation process to determine whether a complaint should be forwarded to the Texas Board of Professional Geoscientists. Enforcement of the Texas Geoscience Practice Act is diminished when a state agency resolves a potential complaint against a licensed geoscientist without involving the Texas Board of Professional Geoscientists.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Amend statute to require the Texas Board of Professional Geoscientists to maintain information about filing a complaint against a professional geoscientist on its website. The agency should also provide an option for a complaint to be submitted electronically.
- ♦ **Recommendation 2:** Amend statute to clarify that the Texas Board of Professional Geoscientists should accept a complaint whether or not it is notarized.
- ♦ **Recommendation 3:** Amend statute to require an agency aware of a potential violation of the Texas Geoscience Practice Act to forward the information to the Texas Board of Professional Geoscientists. Agencies with overlapping responsibility for overseeing the work of geoscientists should work together to avoid duplicating investigative efforts.
- ♦ **Recommendation 4:** Amend statute to require the Texas Board of Professional Geoscientists to work with appropriate state agencies to train state employees involved in projects requiring the services of a licensed geoscientist on the complaint process.

DISCUSSION

The Texas Board of Professional Geoscientists (TBPG) was established in 2001 after the Seventy-seventh Legislature, Regular Session, passed the Texas Geoscience Practice Act. TBPG licenses geologists, geophysicists, and soil scientists as well as geoscience firms; ensures compliance with the Texas Geoscience Practice Act; and conducts outreach activities. Licensing of a geoscientist establishes legal accountability for geoscientist's work, indicates a geoscientist achieved a required level of experience and education, and allows civil penalties to be enforced against persons that violated standards set for licensed geoscientists.

Any individual or firm practicing or offering to perform geoscience work for the public must be licensed. Certain activities overseen by agencies such as the Texas Commission on Environmental Quality (TCEQ), the Railroad Commission of Texas (Railroad Commission), the Texas Department of Transportation (TxDOT), and the Texas Water Development Board (TWDB) require a professional

geoscientist by either statute or rule. Examples of these activities include:

- preconstruction site evaluations done to determine a site's suitability for sewage facilities;
- certain mapping, planning, reporting, sampling, and analysis associated with waste permits provided by TCEQ;
- assessment reports and response action plans for efforts associated with the remediation of waste or cleanup of abandoned sites;
- determinations of usable-quality water zones that need to be sealed off to prevent contamination during certain drilling activities;
- authorization for injection or disposal wells for underground storage or disposal of fluids; and
- the modeling of groundwater availability and sampling of groundwater for legislatively mandated reports.

Statute exempts certain professionals engaged in geoscientific-related work from geoscientist licensing requirements. Some exclusions include:

- licensed engineers performing work that is both engineering and geoscientific in nature;
- water well drillers and water pump installers;
- work performed exclusively in the exploration and development of energy resources, base metals, or minerals if done in and for the benefit of private industry;
- teaching; and
- certain persons evaluating specific on-site locations for sewage disposal systems.

Since TBPG's inception, the annual number of licensed geoscientists has been approximately 5,000. As **Figure 1** shows, fiscal year 2008 had the highest number of licensed geoscientists with more than 6,000. TBPG attributes the decrease in the number of licensees after fiscal year 2008 to natural attrition, increases in licensing fees, new requirements for continuing education, and statutory exemptions from licensure.

FIGURE 1
LICENSES ISSUED BY THE BOARD OF PROFESSIONAL GEOSCIENTISTS, FISCAL YEARS 2007 TO 2012

FISCAL YEAR	LICENSES ISSUED
2007	5,026
2008	6,361
2009	5,061
2010	5,079
2011	5,535
2012*	4,823

*Estimated.
SOURCE: Legislative Budget Board.

COMPLAINTS AGAINST LICENSED GEOSCIENTISTS

TBPG is required to enforce the Texas Geoscience Practice Act and to determine whether disciplinary or other action should be taken by investigating all complaints it receives. Anyone can initiate a complaint. TBPG staff may also initiate a complaint upon receiving information indicating a possible violation. Complaints can be brought to TBPG for any action believed to violate the Texas Geoscience Practice Act or conduct considered detrimental to public health, safety, and welfare. The offering of public geoscience services and qualifications with an expired license or no license is the most common complaint for which disciplinary action occurs.

As shown in **Figure 2**, TBPG has received an annual average of 16.8 complaints within its jurisdiction since its establishment. The resolution of some complaints occurs in the fiscal year after the complaint was filed due to the time necessary to process the complaint. TBPG has resolved a total of 102 complaints as **Figure 2** shows. Of these complaints, the agency resolved 93 in the past three fiscal years. This is a result of changes made to the agency's

FIGURE 2
BOARD OF PROFESSIONAL GEOSCIENTISTS COMPLAINT RESOLUTIONS, FISCAL YEARS 2007 TO 2012

FISCAL YEAR	JURISDICTIONAL COMPLAINTS RECEIVED	COMPLAINTS RESOLVED
2007	4	4
2008	0	1
2009	5	4
2010	6	25
2011	62	47
2012*	24	21

*Estimated.
SOURCE: Legislative Budget Board.

procedures regarding complaints and their resolution. Since fiscal year 2007, complaint resolution has most commonly resulted in non-disciplinary warnings, or advertisements, and non-public reprimands by TBPG. TBPG may initiate the following disciplinary actions according to its rules:

- suspend, permanently revoke, or refuse to issue or renew a license, registration, or certification;
- issue a public or private reprimand;
- impose limitations, conditions, or restrictions on an individual or firms practice;
- require a violator to participate in a peer review program;
- require a license or certificate holder to obtain remedial education and training;
- impose probation;
- require restitution of compensation or fees;
- impose an administrative penalty; or
- issue a cease and desist order.

In fiscal year 2011, all but one complaint filed originated from TBPG. No state agencies have ever filed complaints, although two complaints were filed individually by state employees. **Figure 3** shows the originating source of complaints filed with TBPG since fiscal year 2007.

TBPG maintains a form for filing a formal complaint against a licensed geoscientist or reporting possible violations of the Texas Geoscience Practice Act. This form is available on TBPG's website; however, it does not include detailed online instructions. Including instructions on how to file a complaint would help a person unfamiliar with TBPG's operations to understand the process. Other licensing entities including the Texas Board of Professional Engineers, Texas Board of Professional Land Surveying, Texas State Board of Pharmacy, and Texas Board of Nursing include "how to file a complaint" guides on their websites.

FIGURE 3
SOURCE OF COMPLAINTS FILED WITH THE BOARD OF PROFESSIONAL GEOSCIENTISTS, FISCAL YEARS 2007 TO 2011

FISCAL YEAR	COMPLAINTS RECEIVED	INTERNAL	PUBLIC
2007	4	0	4*
2008	0	0	0
2009	5	3	2*
2010	25	6	19
2011	62	61	1

*One complaint during each of these fiscal years was submitted by a state employee acting alone and not as a representative of a state agency. TBPG classifies these complaints as being filed from the public since they were not officially filed on behalf of a state agency.
SOURCE: Texas Board of Professional Geoscientists.

A complaint form must be mailed to TBPG's post office box, although exhibits for consideration of a complaint may be e-mailed or faxed to TBPG. The Texas State Board of Pharmacy allows persons with a complaint to submit their complaint form either electronically or in writing.

Recommendation 1 would amend the Texas Occupations Code to require information on how to file a complaint be made available on TBPG's website. This requirement is consistent with Texas Occupations Code, Section 1001.251(c), which requires the Board of Professional Engineers to maintain on its website information for filing a complaint and the form used to file a complaint. Recommendation 1 would also require TBPG to make it easier to submit a complaint by offering an option to electronically submit the complaint form. This option could be via e-mail, an online form, or other means.

Unlike complaint forms used by other regulatory entities, TBPG's form requires a notarized signature and seal. TBPG reported this requirement was included in an effort to comply with Texas Occupations Code, Section 1002.202(b)(2), which requires a complaint from a member of the public to be "sworn to by the person making the complaint." TBPG considered removing the notary requirement but is concerned this would create legal grounds for dismissal of a complaint.

Requiring a notary to sign and seal a complaint is inconsistent with requirements of other regulatory entities. This unnecessary step could deter some persons from filing a complaint. TBPG could modify the complaint form to include a statement of certification by the person submitting the form attesting that the information provided is true and accurate. Recommendation 2 would amend the Texas Occupations Code to require TBPG to accept a complaint form whether or not it is notarized. This statutory change would clarify that notarization of a complaint is not required to meet requirements for the complaint process. This amendment is similar to the complaint process statutorily outlined for the Texas Board of Professional Land Surveyors in Texas Occupations Code, Section 1071.203(c).

SHARING OF POTENTIAL VIOLATIONS BETWEEN AGENCIES

Statute prohibits an unlicensed person from preparing a geoscientific report required by state or federal law, state agency rule, or federal regulation. State agencies required to use the services of a professional geoscientist in preparation of a report or other activity are, therefore, in a position to identify evidence of misconduct by a geoscientist or geoscience firm. These agencies should share information regarding a potential violation with TBPG. TBPG is charged with the responsibility of determining whether a questionable act violated the rules and statutes it oversees. Additionally, TBPG is responsible for approving annual licenses for professional geoscientists and it should have access to information regarding potential violations of statute or rule when considering license renewal.

TBPG has entered into Memorandums of Agreement (MoA) with the Railroad Commission of Texas, Texas Board of Professional Land Surveying, and TWDB, explicitly stating these agencies will advise TBPG of any information they identify that may indicate a violation of the statutory requirements for professional geoscientists. However, agreements TBPG has signed with TCEQ and the Texas Board of Professional Engineers do not include this clause. In addition, as of the end of fiscal year 2012, TBPG did not have an MoA with TxDOT, but the agencies were working to establish an agreement. The state's ability to consistently address potential statutory violations by a geoscientist is weakened without an agreement clarifying that TBPG will be informed of possible violations by other state agencies routinely observing geoscientific work.

TxDOT reports that if an employee became aware of a potential violation of the Texas Geoscience Practice Act, the employee would likely inform their supervisor of the violation. The employee would then be advised to file an individual complaint as prescribed by the Texas Geoscience Practice Act and TBPG would handle the matter.

TCEQ developed an internal procedure to guide its staff on the referral of inappropriate geosciences work to TBPG. The agency indicated its employees were not aware of how to proceed with a complaint to TBPG. According to TCEQ procedures

> "…TCEQ staff have an obligation to adhere to the policies and procedures of [TCEQ] to resolve deficiencies in work submitted to the agency. When issues with geoscientific work have not been adequately resolved using the Agency's normal course of action, it may be appropriate to make a complaint referral to the TBPG."

TCEQ developed a Professional Geoscientist Workgroup that reviews complaints raised by its staff. If the workgroup agrees a complaint is warranted it will transmit the complaint to TBPG; however, if it does not agree, the complaint originator is notified TCEQ will not forward the referral. Agencies that make an internal determination regarding potential violations by a professional geoscientist circumvent TBPG's authority to enforce the Texas Geoscience Practice Act.

To help ensure TBPG has access to information regarding licensed geoscientists practicing in the public sphere and the ability to enforce the Texas Geoscience Practice Act, Recommendation 3 would amend the Texas Occupations Code to require a state agency aware of information that may be grounds for an investigation of or a disciplinary action against a person or firm that is required to be licensed pursuant to the Texas Geoscience Practice Act to report the information to TBPG. Agencies with overlapping responsibility for overseeing the work of geoscientists should work together to avoid duplication of investigative efforts.

This recommendation is consistent with statutory requirements for TBPG to refer potential violations of persons licensed by other agencies and is similar to the existing statutory requirement for health regulatory agencies to share information of potential violations outside of their jurisdiction. Texas Government Code, Section 774.002, states

> "A health care regulatory agency that, in the course of an audit, review, investigation, or examination of a complaint, obtains information pertaining to the complaint that it believes may be grounds for another healthcare regulatory agency to conduct an investigation of or institute a disciplinary proceeding against a health care provider shall forward the information and any subsequently obtained information or final determination regarding the health care provider to the other health care regulatory agency."

TCEQ attributed the development of its internal procedures to uncertainty among some staff of how to proceed with a complaint against a professional geoscientist. TBPG is currently developing a guidance document for TCEQ staff that will explain when a complaint should be filed. Recommendation 4 would amend the Texas Occupations Code to require TBPG to work with appropriate state agencies to educate state employees involved in work

requiring the use of a licensed geoscientist on the complaint process. Statute should also be amended to require appropriate state agencies to work with TBPG on providing this guidance to state employees. This language would be similar to the requirement laid out in Texas Occupations Code, Section 1071.201(a) and (b) for the Board of Professional Land Surveyors to prepare information describing the procedures for filing and resolving complaints and making this information available to appropriate state agencies.

FISCAL IMPACT OF THE RECOMMENDATIONS

It is expected that any costs associated with these recommendations would not be significant and could be absorbed within existing resources. Recommendation 1, requiring TBPG to simplify the process of submitting a complaint, could be addressed by modifying TBPG's website. It is assumed these modifications would be minimal and would be completed using existing resources. Recommendation 2, clarifying TBPG is required to accept a complaint with or without a notary signature, would have no fiscal impact. Recommendation 3, requiring a state agency to forward information regarding a potential violation to TBPG, could result in an increase in investigations by TBPG. Since TBPG already conducts investigations of this type and the number of complaints that may be received in any given year is not known, it is assumed TBPG could absorb this cost. Recommendation 4, requiring TBPG to work with appropriate state agencies to train state employees on when and how to file a complaint, is an expansion of an activity TBPG has already begun and could be completed using existing resources.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

REDUCE THE NUMBER OF UNINSURED DRIVERS BY ESTABLISHING A LOW-INCOME AUTOMOBILE INSURANCE PROGRAM

Texas statute requires drivers to be financially responsible for collisions they cause. This law is typically complied with by maintaining minimum liability insurance that covers $30,000 for each injured person (up to $60,000 per accident) and $25,000 for property damage per accident. Data show a relationship between vehicles identified as uninsured by the Texas Department of Insurance, poverty rates, and median income. Additional data show a disproportionate number of persons in geographic areas with limited access to automobile insurance have been convicted of driving without insurance.

The number of uninsured drivers in Texas is unknown; however, estimates range from 13.1 percent to 15.0 percent. In May 2012, the Texas Department of Insurance estimated 2.6 million vehicles in Texas were uninsured. Accidents caused by uninsured drivers contribute to uncompensated trauma care costs and increase the cost of purchasing motor vehicle insurance in Texas. Establishing a low-income automobile insurance program would provide an affordable option for low-income Texans to purchase minimum liability insurance and help reduce the number of uninsured drivers in the state.

FACTS AND FINDINGS

- ♦ The 2011 Affordable Car Insurance Index ranked Texas thirty-first out of the 50 states and District of Columbia for affordable car insurance. The National Association of Insurance Commissioners estimated the average cost of vehicle liability insurance in Texas was $481 in 2009; slightly more than the national average.
- ♦ A survey of trauma centers found 33.5 percent to 66.9 percent of uncompensated trauma care treated at various trauma centers across the state resulted from motor vehicle crashes. This care was provided to persons in motor vehicle accidents who did not have insurance. The state appropriated $133.7 million for the 2012–13 biennium to help offset the cost of uncompensated trauma care.
- ♦ Of Texans subject to the Driver Responsibility Program for driving without insurance from fiscal years 2009 to 2011, 1.8 million, or 38.0 percent, lived in the 3.0 percent of zip codes categorized as underserved areas for personal automobile insurance.
- ♦ Several states have established programs or enacted legislation to provide affordable automobile insurance to low-income drivers. The experience of these states has shown that without an effective strategy to inform the public about the program its effectiveness in reducing uninsured rates will be limited.

CONCERNS

- ♦ Uninsured drivers increase the cost of automobile insurance coverage for all Texans. In 2010, Texans paid $1.1 billion for uninsured motorist coverage. The average annual cost of an individual policy for uninsured/underinsured motorist coverage was $104.
- ♦ Low-income Texans are more likely to lack automobile insurance coverage due to cost than Texans with higher incomes. As of May 2012, 58.6 percent of registered vehicles that could not be matched with an insurance policy by the Texas Department of Insurance were located in counties with higher than average poverty rates. For every 10.0 percent decrease in county median income, the number of registered vehicles without a matching insurance policy in a county is expected to increase by 13.2 percent.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Amend statute to require the Texas Department of Insurance to establish a low-income automobile insurance program that provides minimum liability insurance coverage to qualifying low-income individuals in Texas.
- ♦ **Recommendation 2:** Include a contingency rider in the 2014–15 General Appropriations Bill appropriating $1 million in General Revenue Funds (i.e., Insurance Maintenance Tax) in both fiscal years 2014 and 2015 to the Texas Department of Insurance to establish a low-income automobile insurance program.
- ♦ **Recommendation 3:** Include a contingency rider in the 2014–15 General Appropriations Bill directing the Texas Department of Insurance to report quarterly

to the Legislative Budget Board's Automated Budget and Evaluation System of Texas on key measures for the low-income automobile insurance program.

- **Recommendation 4:** Include a contingency rider in the 2014–15 General Appropriations Bill requiring the Texas Department of Insurance, Texas Department of Motor Vehicles, Texas Department of Public Safety, and Texas Commission on Environmental Quality to inform uninsured drivers of the low-income automobile insurance program through existing programs at each of these agencies.
- **Recommendation 5:** Amend statute to require automobile insurance companies in Texas to inform prospective policy holders requesting coverage meeting state minimum requirements of the low-income automobile insurance program.

DISCUSSION

Texas law requires motorists to pay for damages resulting from any collision they cause. The Texas Transportation Code provides several options for motorists to prove their financial responsibility; the most commonly used option is to purchase automobile liability insurance. Statute requires minimum liability coverage of $30,000 per injured person, up to $60,000 per accident, and $25,000 for property damage per accident. The penalty for driving without establishing financial responsibility is a fine of up to $350 and court costs for first-time offenders. Subsequent offenders may be fined up to $1,000 and also have their driver license and vehicle registration suspended for up to two years.

The exact number of uninsured drivers in Texas is unknown. The insurance industry estimates the state's rate of uninsured drivers is 15.0 percent. This is based on the ratio of uninsured motorist claims frequency to bodily injury claim frequency. The Texas Department of Insurance (TDI) also estimates the rate of uninsured motorists using data from the TexasSure database. At the direction of the Texas Legislature, TDI established the TexasSure Program in 2008. This is a database that compares vehicle registration records with personal automobile insurance policy data provided by insurance companies. If a registered vehicle is not matched to an automobile insurance policy, or vice versa, TDI contacts the vehicle owner to try to resolve the issue. TDI reports quarterly on the number of unmatched vehicles in Texas. In May 2012, TDI estimated 2.6 million (13.1 percent) vehicles in Texas were uninsured.

COST OF UNINSURED DRIVERS IN TEXAS

According to Insurance Networking, the rate of uninsured drivers in a state is one of several factors impacting the average cost of auto insurance. The 2011 Affordable Car Insurance Index ranked Texas thirty-first out of the 50 states and District of Columbia for affordable car insurance. TDI estimated the average automobile insurance expenditure in Texas was $854 in 2008, making it higher than the national average.

Drivers who comply with the mandatory insurance law also pay for those that do not by purchasing uninsured/underinsured motorist coverage. This coverage pays for property damage and medical expenses in a motor vehicle crash in which the at-fault driver is uninsured. It also pays for crash-related expenses if the at-fault driver is insured but their coverage limits do not cover all property damages or medical expenses resulting from the accident. According to TDI, Texans paid approximately $1.1 billion in 2010 for uninsured/underinsured motorist coverage; the average annual cost of this type of policy was $104. The number of drivers purchasing uninsured/underinsured motorist coverage in Texas is unknown. However, TDI found that 69.0 percent of drivers insured by county mutuals (which are defined by Chapter 912 of the Texas Insurance Code and were originally designed to provide insurance in rural communities and now provide auto insurance statewide) and 87.0 percent of drivers insured by other insurers buy this coverage.

Injuries resulting from vehicle crashes involving uninsured motorists are a primary contributor to the cost of uncompensated trauma care in Texas. The state appropriated $133.7 million in General Revenue–Dedicated Funds during the 2012–13 biennium from the Permanent Fund for Emergency Medical Services and Trauma Care Account; EMS, Trauma Facilities, Trauma Care Systems Account; and Designated Trauma Facility and EMS Account to help offset the cost of uncompensated care at trauma facilities. Statewide data compiling the amount of uncompensated trauma care resulting from motor vehicle crashes is not available. However, a survey of a sample of the state's trauma centers showed that while a small percentage of overall emergency room visits result from motor vehicle crashes, between one-third and two-thirds of visits by uninsured patients stem from motor vehicle crashes, as shown in **Figure 1**.

FIGURE 1
MOTOR VEHICLE CRASH INJURIES RESULTING IN UNCOMPENSATED CARE, CALENDAR YEARS 2008 TO 2011

TRAUMA CENTER	YEAR	PERCENTAGE OF ALL EMERGENCY ROOM VISITS RELATED TO MOTOR VEHICLE CRASHES	PERCENTAGE OF MOTOR VEHICLE CRASH RELATED EMERGENCY ROOM VISITS THAT ARE UNINSURED
University of Texas Medical Branch	2011	3.0%	48.0%
Seton Family of Hospitals	2011	3.0%	43.5%
Memorial Hermann	2011	8.6%	33.5%
University Medical Center Lubbock	2011	Unavailable	54.0%
Texas Health Fort Worth	2011	5,395*	35.4%
Christus St. Elizabeth	2010	2.5%	54.0%
West Houston Medical Center	2008	2.1%	66.9%

*Texas Health Fort Worth provided the number of motor vehicle crash related visits rather than a percentage.
Sources: Legislative Budget Board; Texas Hospital Association.

PREVIOUS EFFORTS TO REDUCE UNINSURED DRIVERS IN TEXAS

According to the Insurance Information Institute, insurance companies may consider a variety of factors when determining whether to write a policy and premium amounts. These include driving history, how often a car is driven, where a car is parked, age, gender, the vehicle's value, credit history, and the type and amount of coverage. Persons with accidents or tickets on their driving record may be considered high-risk and this may result in insurance companies adding surcharges to a premium. TDI has stated these surcharges can increase premium costs as much as 60.0 percent.

Texas residents who are refused insurance coverage by two or more insurance companies qualify for insurance through the Texas Automobile Insurance Plan Association (TAIPA). The Texas Insurance Code, Chapter 2151, requires all insurance companies authorized to write motor vehicle liability policies in Texas to participate in TAIPA. Applications for insurance are equitably assigned among members. TAIPA coverage is more expensive than coverage provided by most insurance companies and surcharges for traffic tickets and accidents are higher than in the traditional market. TAIPA does not provide collision or comprehensive coverage or higher liability limits than the law requires. However, personal injury protection and uninsured/underinsured motorist coverage may be added.

In 2010, the average annual premium for a liability policy under TAIPA was $549. The average cost for a policy including uninsured motorist and personal injury protection was $582. Approximately one-half of TAIPA participants have cars from 11 to 15 years old, while 36.0 percent have cars from 5 to 10 years old. No participants have a vehicle less than five years old. The majority of TAIPA participants are age 25 to 64, as shown in **Figure 2**.

A sample of TAIPA applications in 2011 showed 63.0 percent of applicants had no moving violations on their driving records and 10.0 percent had driver license issues such as a suspended license. The remaining 27.0 percent of applicants had previous tickets, accidents, or involvement in an accident without automobile insurance.

TDI rules encourage the traditional insurance market to take policyholders out of TAIPA and insure them at lower rates after a year without tickets or accidents. Companies are required to offer less expensive voluntary policies to TAIPA policyholders who have not been issued a ticket or involved in an accident in the past three years. **Figure 3** shows that from 2006 to 2011 the number of applications received for TAIPA decreased by 66.0 percent. Since the TexasSure system was established in 2008, TAIPA applications have continued to decline. This trend, combined with the number of TAIPA applicants with driving records without moving violations, suggests that factors besides poor driving history contribute to the state's rate of uninsured drivers.

RELATIONSHIP BETWEEN INCOME AND UNINSURED DRIVERS IN TEXAS

The American Association of Motor Vehicle Administrators reports 82.0 percent of uninsured drivers indicated they either could not afford insurance or their vehicle was not operable or in use. The Insurance Information Institute has also stated affordability is a factor in a driver's decision to purchase or not purchase automobile insurance.

Figure 4 shows the cost of vehicle insurance is one of the highest expenditure categories associated with owning a

FIGURE 2
AGE OF TEXAS AUTOMOBILE INSURANCE PLAN ASSOCIATION PARTICIPANTS, CALENDAR YEARS 2006 TO 2010

YEAR	24 AND YOUNGER	25 TO 64	65 AND OLDER
2010	30%	61%	10%
2009	28%	62%	9%
2008	27%	64%	10%
2007	26%	64%	11%
2006	24%	64%	12%
Average	27%	63%	10%

NOTE: Totals may not equal 100 percent due to rounding.
SOURCE: Texas Department of Insurance.

FIGURE 3
APPLICATIONS RECEIVED AND ASSIGNED THROUGH THE TEXAS AUTOMOBILE INSURANCE PLAN ASSOCIATION, CALENDAR YEARS 2005 TO 2011

YEAR	APPLICATIONS RECEIVED	APPLICATIONS ASSIGNED
2011	7,914	7,364
2010	9,200	8,725
2009	10,887	10,299
2008	13,731	12,896
2007	18,095	16,780
2006	25,808	23,634

SOURCE: Texas Department of Insurance.

vehicle. The national average paid for all types of automobile insurance in 2011 was $983. It was the third largest annual vehicle-related expenditure after the net outlay for purchase and gasoline and motor oil.

Automobile insurance makes up a disproportionate share of a low-income family's disposable income, as shown in **Figure 5**. According to data from the U.S. Bureau of Labor Statistics, the wealthiest fifth of households spent an average of $1,451, or 1.0 percent, of their total disposable income on vehicle insurance premiums in 2011. In comparison, the poorest fifth of households spent an average of $522, or 5.2 percent, of their disposable income on vehicle premiums in 2011. This amount was more than five times the income share of the highest-income families.

A 2012 publication by the Consumer Federation of America used Consumer Expenditure Survey data to estimate the total amount spent on each vehicle-related expenditure category by households in the two lowest income quintiles. All households in the lowest two quintiles have incomes below $40,000 with an average annual income of approximately $10,000 in the lowest quintile and $27,000 in the second-lowest quintile. The study estimated these households combined spent $30 billion on auto insurance premiums in 2010. This made automobile insurance one of their largest expenditures and higher than the approximately $6 billion the two quintiles spent on life and other personal insurance premiums.

In 2006, the Brookings Institute published findings showing the highest prices for auto insurance written by three major insurance companies were in the lowest income neighborhoods in a sample of metropolitan areas in which approximately one-fourth of Americans reside. The price differential varied, with lower-income neighborhoods paying $51 more than upper-income neighborhoods in San Francisco and approximately $1,000 more in New York. The study acknowledged that because of limited disclosure requirements, sufficient data is not available to analyze the full effect of factors such as credit scores, occupation, and education on premium rates.

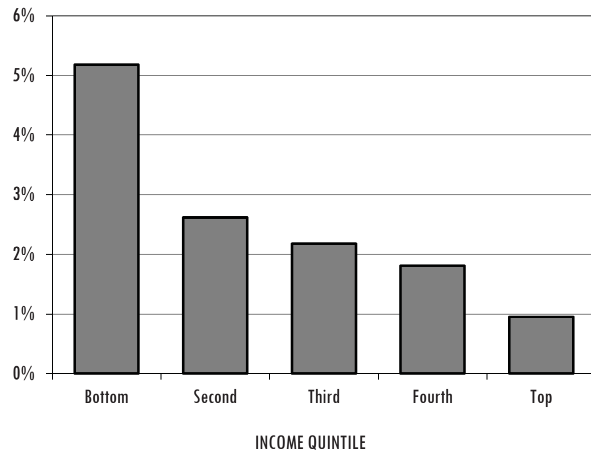
No study analyzing the relationship between income and uninsured drivers in Texas has been done recently. Therefore,

FIGURE 4
ANNUAL VEHICLE-RELATED EXPENDITURES BY INCOME QUINTILE, CALENDAR YEAR 2011

ITEM	LOWEST 20 PERCENT	SECOND 20 PERCENT	THIRD 20 PERCENT	FOURTH 20 PERCENT	HIGHEST 20 PERCENT	AVERAGE
Vehicle purchase (net outlay)	$827	$1,358	$2,208	$3,392	$5,557	$2,669
Gasoline and motor oil	$1,227	$1,981	$2,694	$3,295	$4,073	$2,655
Vehicle insurance	$522	$714	$992	$1,236	$1,451	$983
Maintenance and repairs	$315	$526	$739	$1,017	$1,427	$805
Vehicle rental, leases, licenses, and other charges	$139	$240	$363	$466	$956	$433
Vehicle finance charges	$45	$119	$228	$325	$447	$233

NOTE: Quintiles of income before taxes.
SOURCE: U.S. Bureau of Labor Statistics.

FIGURE 5
PERCENTAGE OF DISPOSABLE HOUSEHOLD INCOME SPENT ON VEHICLE INSURANCE, CALENDAR YEAR 2011



SOURCE: U.S. Bureau of Labor Statistics.

Legislative Budget Board (LBB) staff examined the rates of uninsured vehicles by county compared to a county's poverty rate and median income. LBB staff also reviewed the number of Texans in the Driver Responsibility Program due to driving without insurance and living in zip codes considered underserved areas for personal automobile insurance.

As of May 2012, 58.6 percent of registered vehicles not matched with an insurance policy through the TexasSure Program were located in counties with poverty rates above Texas' average of 18.5 percent. The average rate of unmatched registrations by county in Texas was 13.9 percent. This rate is based on two quarters of TexasSure data that were available after adjustments to the database were made in 2011. At this time multiple listings of the same vehicle were removed from the database in an effort to improve data accuracy. Information to determine the impact of these adjustments on the state's rate of uninsured vehicles was not tracked by TDI. **Figure 6** shows county poverty rates in the 10 counties with the highest rate of unmatched registration were above the 13.8 percent average among Texas counties. For all but two counties, the rate was higher than the state average. Conversely, **Figure 7** shows that of the 10 Texas counties with the lowest rate of unmatched registrations, one-half have a rate of poverty below the county average in Texas counties.

FIGURE 6
RATE OF UNMATCHED REGISTRATIONS IN THE TEXAS COUNTIES WITH THE HIGHEST RATES OF POVERTY AMONG PERSONS AGE 19 AND OLDER, DECEMBER 2011 TO MAY 2012

COUNTY	RATE OF UNMATCHED REGISTRATIONS	RATE OF POVERTY
Cameron	27.5%	35.8%
La Salle	25.7%	18.4%
Webb	25.5%	31.5%
Jim Hogg	25.1%	24.8%
Hidalgo	24.9%	33.4%
Maverick	24.2%	16.2%
Starr	23.9%	39.2%
Scurry	23.1%	17.4%
Loving	23.0%	14.5%
Zapata	21.8%	32.3%
State Average	**13.9%**	**13.8%**

SOURCE: Legislative Budget Board.

FIGURE 7
RATE OF UNMATCHED REGISTRATIONS IN THE TEXAS COUNTIES WITH THE LOWEST RATES OF POVERTY AMONG PERSONS AGE 19 AND OLDER, DECEMBER 2011 TO MAY 2012

COUNTY	RATE OF UNMATCHED REGISTRATIONS	RATE OF POVERTY
Concho	9.7%	28.4%
Gillespie	9.7%	12.1%
Goliad	9.7%	15.5%
Denton	9.6%	21.3%
Lampasas	9.5%	34.4%
Real	9.4%	24.1%
Williamson	9.1%	7.9%
Collin	9.0%	7.7%
Wilson	9.0%	12.1%
King	1.0%	12.5%
State Average	**13.9%**	**13.8%**

SOURCE: Legislative Budget Board.

LBB staff conducted a regression analysis to measure the correlation between the rate of vehicle registrations unmatched with an automobile insurance policy and poverty rates. Demographic and economic variables included in the analysis were poverty rates, median household income, county population, and the number of vehicle registrations not matched with an insurance policy. Results showed

evidence of a statistically significant inverse relationship between unmatched registrations and county median income. Specifically, holding all other variables constant, for every 10.0 percent decrease in county median income, the expected percentage of unmatched vehicle registrations in a county increased by 13.2 percent. This analysis suggests that drivers in counties with lower median incomes have higher rates of uninsured drivers than other counties in the state.

A 2011 study by the Consumer Federation of America found automobile insurance is less accessible in low-income areas than higher-income areas; classifying them as underserved areas. The percentage of insurance offices located in areas with the lowest-median incomes has been found to be as much as 52.0 percent lower than the number of insurance offices in areas with the highest-median incomes.

The Texas Insurance Commissioner is statutorily required to designate underserved areas for personal automobile insurance. Statute requires the Commissioner to consider the availability of insurance, the number of uninsured drivers, the number of drivers insured through TAIPA, and any other relevant factor when making this determination. The Commissioner has also chosen to consider the driving age population by zip code. Lastly, the Commissioner includes one-cost related factor, the number of automobile insurance policies written at rates at or below rates for assigned risk policies. In September 2012, 387 zip codes, or 2.7 percent of all Texas zip codes, were considered underserved areas for personal automobile insurance. These zip codes have been classified as underserved since 1995.

The Driver Responsibility Program assesses a surcharge of $150 for three years on persons convicted of certain driving violations, including driving without insurance. A review of Texans subject to the Driver Responsibility Program for driving without insurance from fiscal years 2009 to 2011 found a disproportionate amount, 38.0 percent, lived in the 2.7 percent of zip codes categorized by the Commissioner as underserved areas for personal automobile insurance.

Assuming there will always be people who are unable to afford automobile insurance, and that insuring this segment of the population better serves communities as a whole, the National Association of Insurance Commissioners supports alternative and low-cost auto insurance programs.

OTHER STATE'S EFFORTS TO INSURE LOW-INCOME DRIVERS

Minimum liability insurance is required in 49 states and the District of Columbia; however this requirement has not resulted in all drivers obtaining minimum coverage in any state. According to the Insurance Research Council, Texas' 2011 rate of uninsured drivers was 15.0 percent. This was higher than the national average of 13.8 percent and tied for fifteenth highest in the country. Massachusetts and Maine had the lowest rate of uninsured drivers at 4.5 percent.

To address the high rate of uninsured drivers, California piloted the Low Cost Automobile Insurance Program (CLCAIP) in 2000 and made the program available statewide in December 2007. The program served 59,298 Californians from 2000 to 2011. To qualify for CLCAIP an individual must:

- have a household income not exceeding 250 percent of the federal poverty level;
- be age 19 or older and a California resident;
- have a good driving record;
- be insuring a vehicle valued under $20,000; and
- have been licensed for the previous three years.

In 2010, 96.0 percent of CLCAIP applicants were eligible for coverage. At the end of 2010, over 11,500 low-cost automobile policies were in place through the program. Approximately 66.0 percent of motorists covered by the program had previously been uninsured. Coverage provided by the program is below the state's minimum liability insurance requirement; however, statute provides an exception to minimum state requirements for enrollees. Every auto insurer doing business in the state is required to participate. Currently, approximately 2,200 insurance producers write CLCAIP policies.

Premiums for the low-cost insurance program are set for each county at a rate sufficient to cover losses and expenses in the county. During 2010, annual premium prices ranged from $248 to $358 depending upon the participant's county of residence. In lieu of paying the full annual premium, individuals may pay a:

- $125 deposit with the remainder to be paid within 30 days;
- $100 deposit with the remainder to be paid in six bi-monthly installments;

- $125 deposit with balance paid in five bi-monthly installments; or
- 15 percent of premium deposit with balance paid in six bi-monthly installments.

In 2005, funding was provided to conduct an outreach and education campaign designed to inform uninsured drivers of the CLCAIP option. The funding came from a portion of a $0.30 assessment levied against insurance companies for each vehicle they insure. In California's fiscal years 2009–10 and 2010–11 the program received a combined $2.8 million for outreach activities. Activities included contracting with a public relations firm, implementing a media campaign, developing public materials, and partnering with entities such as the Department of Motor Vehicles, Women Infants and Children Program, Workforce Development programs, and community groups and organizations to provide training as well as target persons likely to be eligible for the program.

New Jersey also has a low-income automobile insurance program. New Jersey's Basic Policy is intended for persons with few family responsibilities or assets. It is targeted toward young drivers just beginning to establish themselves and aims to provide minimum protection for persons that cannot afford more comprehensive coverage. New Jersey's Basic Policy provides $15,000 in personal injury protection, up to $250,000 in medical benefits for catastrophic injuries, and $5,000 in property damage liability. Policyholders may buy optional $10,000 bodily injury liability coverage but they cannot buy uninsured/underinsured, collision, or comprehensive coverage. The Dollar-A-Day policy option provides drivers who are eligible for federal Medicaid with hospitalization emergency treatment immediately following an accident and treatment of serious brain and spinal cord injuries up to $250,000; as well as a $10,000 death benefit. This policy costs $365 annually.

Any owner of an automobile registered and primarily garaged in New Jersey is eligible to receive a basic policy and all insurers writing automobile insurance in the state are required to provide it. Few drivers in New Jersey have the basic policy; it makes up less than 0.22 percent of all New Jersey automobile insurance policies written. The Department of Banking and Insurance believes the small number of persons purchasing the basic policy results from a lack of information regarding the option.

The State of Hawaii requires free, no-fault coverage be provided to persons that qualify for public assistance. However, the program is not publicized and no data on the program's reach or effectiveness was available.

ESTABLISH A LOW-COST AUTOMOBILE INSURANCE OPTION IN TEXAS TO REDUCE THE STATE'S RATE OF UNINSURED MOTORISTS

Recommendation 1 would amend the Texas Insurance Code to require TDI to establish a low-income automobile insurance program (LIAIP) that offers minimum liability automobile insurance policies to low-income Texans. A policyholder could only purchase or maintain automobile liability insurance through the program for an automobile in their household. Minimum eligibility requirements would require program participants to meet the following criteria:

- the automobile to be insured must be registered in Texas;
- the driver must have been driving for a minimum of three years and qualify as a good driver;
- the value of the automobile to be insured must not exceed $20,000;
- household income must be at or below 250 percent of the federal poverty level or the applicant must have received quotes from a minimum of two insurance companies offering insurance coverage on the voluntary market costing more than 10 percent of the applicant's gross income; and
- applicants that are college students may not be claimed as a dependent on another person's federal income tax return.

TDI would be required to define "good driver" by rule and would be authorized to set additional eligibility requirements as necessary. This should include requirements for premium rate setting. At a minimum, these requirements should include the following elements:

- every program participant is required to pay some amount;
- premium rates should be offered on a sliding scale based on a person's income and considering basic cost of living requirements; or
- premium rates are determined by a person's county of residence.

TDI would also be required to establish an appeals process for the program by rule. TDI should conduct training to

familiarize insurance companies with the program and would be authorized to charge a fee to cover training costs.

Figure 8 shows the gross yearly income of persons that would be eligible for LIAIP based on income that is 250 percent below the federal poverty level. An individual would have an income at or below $27,925 while a family of four would have a household income at or below $57,625.

FIGURE 8
ANNUAL INCOME BASED ON 250 PERCENT OF THE FEDERAL POVERTY LEVEL, CALENDAR YEAR 2012

PERSONS IN HOUSEHOLD	ANNUAL INCOME
1	$27,925
2	$37,825
3	$47,725
4	$57,625
5	$67,525
6	$77,425
7	$87,325
8	$97,225

Source: Medicaid Program.

This program would differ from TAIPA by providing affordable automobile insurance to drivers based on their income level, while TAIPA provides an insurance option for drivers who have been denied coverage on the voluntary market for any reason.

Based on costs of other programs providing services to low-income Texans, it is estimated administrative costs would not exceed $1 million per fiscal year. Recommendation 2 would appropriate revenue, via a contingency rider in the 2014–15 General Appropriations Bill, from the Insurance Maintenance Tax to TDI to oversee LIAIP. Administrative activities that would be funded out of this appropriation include items such as salaries, training, supplies, and equipment.

Recommendation 3 would include a contingency rider in the 2014–15 General Appropriations Bill to put in place performance measures to track the program's progress in providing automobile insurance to low-income drivers and reducing the state's overall rate of uninsured drivers. The first of these measures would report the number of applicants for the program and the second measure would monitor the number of program applications assigned program coverage. These measures would help determine whether the awareness campaign is reaching the intended audience. The third measure would track the number of previously uninsured motorists receiving coverage through the new program. The last measure would report the percentage of program participants residing in underrepresented communities to demonstrate whether the program is successfully providing these communities with access to vehicle insurance. The rider would require TDI to report quarterly on the results of these measures to the Legislative Budget Board's Automated Budget and Evaluation System of Texas, which is used to track program performance across state government.

The experience of the New Jersey Basic Policy program has shown that without an effective way to inform residents of the low-income automobile insurance option the program's reach will be limited. Recommendation 4 would include a rider in the 2014–15 General Appropriations Bill to require TDI, the Department of Motor Vehicles (DMV), the Department of Public Safety (DPS), and the Texas Commission on Environmental Quality (TCEQ) to launch a campaign informing potential program participants about LIAIP requirements and how to apply. This could be absorbed within existing resources if done in conjunction with programs already in place at each of these agencies. As part of the TexasSure system, TDI contacts individuals with registered vehicles that appear to be uninsured. DMV mails registration renewal notices to all registered vehicle owners. DPS administers the Driver Responsibility Program and mails notices to persons that have been convicted of certain driving offenses; including those convicted of driving without insurance. The AirCheck Texas Drive a Clean Machine Program at TCEQ provides repair or replacement assistance to low-income vehicle owners whose vehicle has failed an emissions test.

Recommendation 5 would amend the Texas Insurance Code to require automobile insurance companies in Texas to inform prospective customers requesting coverage that meets state minimum liability requirements of the low-income automobile insurance program. This would help to inform persons looking for basic coverage of the program.

In 2011, 7.7 million Texans older than age 19 had incomes below 250 percent of the federal poverty level, as classified by the U.S. Census Bureau. This is the maximum number of Texans that could have driven a minimum of three years and who would qualify for the program based solely on income. This number does not exclude persons who do not own a vehicle, whose vehicle exceeds the proposed threshold for program participation, who do not qualify as a good driver or are claimed as a dependent on another's federal income tax

form, who have not been driving a minimum of three years, or persons that do not drive. It is assumed that not all 7.7 million Texans would qualify for the program. Additionally, since TDI estimates 2.6 million vehicles in Texas are uninsured, it is expected the number of persons applying for the program would be much lower than the 7.7 million that qualify based solely on income level and age.

FISCAL IMPACT OF THE RECOMMENDATIONS

The cost of providing policies required by the low-income automobile insurance program that would be required by Recommendation 1, would be paid for by individual policy premiums. TDI would have administrative costs associated with setting up the program.

Recommendation 2 appropriates $1 million in General Revenue Funds (i.e., Insurance Maintenance Tax) to TDI in each fiscal year of the 2014–15 biennium, to cover administrative costs, as shown in **Figure 9**. It is expected TDI would use available balances in its operating fund or increase the maintenance tax rate on motor vehicle insurers to generate sufficient revenue to cover this appropriation.

Recommendation 3 requires TDI to report on non-key measures regarding the program. Since TDI already reports on non-key measures for other programs, it is assumed this could be accomplished within existing resources.

Recommendation 4 requires TDI, DMV, DPS, and TCEQ to inform drivers of the low-income automobile insurance program. This recommendation could be absorbed within existing resources as these agencies have existing outreach mechanisms that connect with the persons they would be required to contact.

Recommendation 5 requires companies writing automobile insurance policies in Texas to ensure prospective policy holders of the low-income policy option. This recommendation would have no fiscal impact to the state. The recommendation could be implemented by including information on an insurance company's webpage or in mailings the companies already send to prospective policy holders. It is expected any cost resulting from this recommendation would not be significant.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

FIGURE 9
ESTIMATED FIVE-YEAR FISCAL IMPACT, FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE REVENUE GAIN/(LOSS) IN GENERAL REVENUE FUNDS INSURANCE MAINTENANCE TAX AND INSURANCE DEPARTMENT FEES	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE FUNDS INSURANCE MAINTENANCE TAX AND INSURANCE DEPARTMENT FEES	CHANGE TO FULL-TIME-EQUIVALENT POSITIONS COMPARED TO THE 2012–13 BIENNIUM
2014	$1,000,000	($1,000,000)	1
2015	$1,000,000	($1,000,000)	1
2016	$500,000	($500,000)	1
2017	$500,000	($500,000)	1
2018	$500,000	($500,000)	1

SOURCE: Legislative Budget Board.

LIMIT STATE FINANCIAL LIABILITY AND INCREASE DEBT SERVICE TRANSPARENCY FOR TUITION REVENUE BONDS

Texas uses tuition revenue bonds as a source of state-supported financing for capital projects at public institutions of higher education. As of August 2012, there was $2.5 billion in debt outstanding for these bonds. The tuition revenue bond program began in 1971 as a method to finance capital projects and comply with a constitutional restriction that prevents using General Revenue Funds to finance higher education projects.

Since the program's inception, the state has approved $4.7 billion in debt authority. Historically the Legislature has appropriated General Revenue Funds to reimburse institutions for the annual tuition revenue bond debt service, including principal and interest. The largest tuition revenue bond statute passed in 2006, with an authorization of $1.9 billion. Each legislature that has approved a bond authorization set its own limit, rather than using an ongoing limit that could identify debt capacity from year to year. In addition, tuition revenue debt service is not readily transparent due to university systems issuing bonds to fund multiple projects in a single issuance. Establishing a statutory limit on tuition revenue bond capacity would provide predictability to the Texas Legislature and institutions for debt authorization. Increasing debt service transparency and clarifying the requirements for lapsing excess debt service appropriations for unissued debt authority would allow the Legislature to maximize the use of limited General Revenue Funds.

FACTS AND FINDINGS

- ♦ From fiscal years 2002 to 2012, state appropriations for reimbursement of tuition revenue bond debt service per year ranged from 0.40 percent to 0.95 percent of the three-year average of unrestricted General Revenue Funds, which excludes revenues that are constitutionally dedicated.
- ♦ The legislative appropriations requests from public institutions of higher education for the 2014–15 biennium included exceptional item requests for new tuition revenue bond debt authority of $4.1 billion, with estimated debt service requests of $683.7 million.

CONCERNS

- ♦ Under current practice, the Texas Legislature authorizes tuition revenue bonds on a periodic basis, without a limit on debt service and bond authorization. The absence of a limit creates uncertainty about the maximum debt service liability and prevents the Legislature from determining debt capacity for new projects.
- ♦ Tuition revenue bonds are often issued with other university revenue bonds in one issuance, which hinders the Legislature's ability to review and verify the accuracy of debt service appropriations requests.
- ♦ The assumptions used for new tuition revenue bond authority may overstate actual interest costs. In 2012, legislative appropriations requests from institutions relating to tuition revenue bond debt service used a 6.0 percent interest rate assumption for new authority, which is higher than most institutions actually incurred for bonds issued in calendar years 2011 and 2012.
- ♦ Rider 9, Section 6, of Special Provisions Relating Only to Higher Education Institutions for tuition revenue bond debt service expenditures does not require the institutions to lapse, or return, unused funds or limit their use to amounts necessary for regularly scheduled debt service payments.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Amend statute to limit tuition revenue bond authorizations by capping annual debt service reimbursement as a certain percentage of the three-year average of unrestricted General Revenue Funds. The recommended limit is 1.25 percent.
- ♦ **Recommendation 2:** Include a rider in the introduced 2014–15 General Appropriations Bill to require the Bond Review Bond to submit its Final Transaction Reports and Semi-Annual Issuer Reports for public institutions of higher education to the Legislative Budget Board, including separate debt outstanding and debt service schedules for tuition revenue bonds.

- **Recommendation 3:** Amend the Special Provisions Relating Only to Higher Education rider on Tuition Revenue Bond expenditures in the introduced 2014–15 General Appropriations Bill to require public institutions of higher education to lapse any funds that exceed the regularly scheduled principal and interest payment on tuition revenue bond debt service appropriations each fiscal year.

DISCUSSION

Texas public universities use both General Obligation (GO) and revenue bonds to fund capital projects. Under authority granted by the Texas Education Code, Chapter 55, public universities are authorized to issue revenue bonds to pay for capital projects. Revenues, including tuition, fees, and grants, can be used to repay the debt service on bonds. Statute limits institution revenue bonds to a term of no more than 50 years. As of August 2012, the debt outstanding for university revenue bonds was $10.5 billion, of which $2.5 billion was for tuition revenue bonds (TRB) and $8.0 billion was for non-TRB bonds.

TRBs represent a subset of the revenue bond authority granted to universities. Since the program's inception in the 1970s, the state has approved $4.7 billion of TRB authority. According to the Texas Higher Education Coordinating Board (THECB), the TRB program initially began with authorizations in 1971 and 1973. The TRB program allowed the Legislature to provide capital funding for new institutions during that time while complying with an existing constitutional provision, Article VII, Section 18-i, that prohibited the University of Texas and Texas A&M University from receiving General Revenue Funds for capital projects. This restriction was extended to all public institutions of higher education in 1984.

Following the 1970s authorizations, additional authorizations were not approved until 1991 when TRB authorizations were made as part of the funding for the South Texas Border Initiative that included 20 institutions over three legislative sessions. In 1997, the Legislature authorized widespread use of TRBs, authorizing $638.5 million for 41 institutions. The use of TRBs has continued, including two large debt authorizations of $1.0 billion in 2001 and $1.9 billion in 2006. **Figure 1** shows the history of TRB authorizations.

The Eighty-second Legislature did not pass legislation for a new TRB authorization during 2011. However, during the regular session bills were filed seeking new authorization, including one that would have provided $3.2 billion for multiple institutions.

LIMITING DEBT SERVICE LIABILITY

Public institutions of higher education issue TRBs and pledge institutional revenues as the source of repayment.

FIGURE 1
TUITION REVENUE BONDS AUTHORIZATIONS, 1971 TO 2009

LEGISLATURE	SESSION	YEAR	AUTHORIZATION AMOUNT (IN MILLIONS)	LEGISLATION
Sixty-second	Regular	1971	$185.0	House Bill 1657
Sixty-third	Regular	1973	57.5	Senate Bill 2, Senate Bill 129
Seventy-second	Regular	1991	30.0	House Bill 2102
Seventy-second	First Called	1991	30.0	Senate Bill 3
Seventy-third	Regular	1993	352.4	House Bill 2058
Seventy-fourth	Regular	1995	9.0	House Bill 2747
Seventy-fifth	Regular	1997	638.5	House Bill 1235
Seventy-seventh	Regular	2001	1,081.8	House Bill 658
Seventy-eighth	Regular	2003	220.4	House Bill 1941, House Bill 2522, House Bill 800
Seventy-eighth	Third Called	2003	48.5	House Bill 28
Seventy-ninth	Third Called	2006	1,858.8	House Bill 153
Eightieth	Regular	2007	13.0	House Bill 1775
Eighty-first	Regular	2009	155.0	House Bill 51
Total Authorized			**$4,679.8**	

Source: Legislative Budget Board.

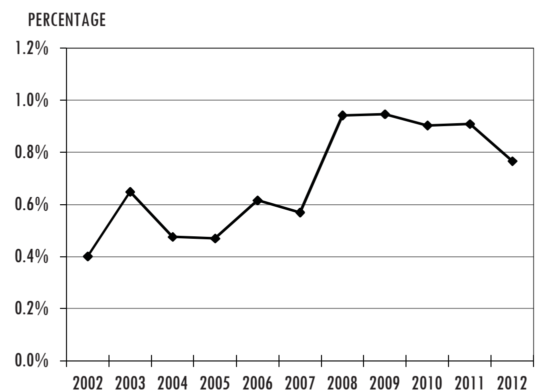
Since the 1970s, the Texas Legislature has generally appropriated General Revenue Funds to reimburse institutions for the annual TRB debt service payment, including principal and interest. One exception to this practice occurred in 2003, when the Legislature approved interest only debt service reimbursement for bonds issued after March 31, 2003. The Seventy-ninth Legislature in 2005 reversed this practice in its appropriations for the 2006–07 biennium, and reinstated full debt service reimbursement for all TRBs.

Recent policy deliberations have considered how best to meet institutions' capital needs while limiting the state's liability for debt service. Varying approaches for capital funding have been considered by public higher education institutions and the Texas Legislature. In 2008, a capital funding workgroup within THECB recommended a GO bond program for public institutions of higher education. In 2011, the interim report by the Senate Finance Committee recommended the Legislature either establish a GO bond program (which would require voter approval) or require future TRB authorizations be repaid by tuition rather than reimbursements of General Revenue Funds for debt service. Any GO bond program repaid with General Revenue Funds would affect the constitutional debt limit (CDL), which limits debt service, including issued, unissued, and new debt, to no more than 5 percent of the three-year average of unrestricted General Revenue Funds, which excludes revenues that are constitutionally dedicated. This debt service limit impacts the amount of GO debt authorizations the Legislature can approve. Since institutions pledge tuition revenues for TRBs, they are not counted in the CDL even though they receive debt service reimbursements of General Revenue Funds.

Each legislature sets its own limit on new TRB authorizations. Neither the constitution nor statute limits the state's TRB debt service obligation. Institution TRB debt service appropriations for 2012–13 biennium totaled $584.3 million. For the 2014–15 biennium, base requests for issued TRB debt service total $587.8 million. Exceptional item debt service requests for 2014–15 biennium related to new TRB authority total $683.7 million. If all base and exceptional item requests were approved, the 2014–15 biennial debt service would total $1.3 billion.

If the Legislature decides to continue the TRB program and approve new authorizations but limit the amount of debt service obligation, one option is to establish a statutory limit on TRB debt service. From fiscal years 2002 to 2012, state appropriations for reimbursement of tuition revenue bond debt service per year ranged from 0.40 percent to 0.95 percent of the three-year average of unrestricted General Revenue Funds. **Figure 2** shows the historical TRB debt service as a percent of the three-year average of unrestricted General Revenue Funds.

FIGURE 2
TUITION REVENUE BOND DEBT SERVICE TO THREE-YEAR AVERAGE OF UNRESTRICTED GENERAL REVENUE FUNDS
FISCAL YEARS 2002 TO 2012



Source: Legislative Budget Board.

A statutory limit that replicates the CDL calculation, but sets a separate, specific amount for TRBs may be a useful metric for limiting debt service while creating a predictable debt capacity. Recommendation 1 would amend the Texas Education Code, Chapter 55, to limit TRB authorizations by capping annual debt service reimbursement at a certain percentage of the three-year average of unrestricted General Revenue Funds. A limit of 1.25 percent, which is slightly more than the historical high for this ratio, would provide $2.1 billion in debt capacity. **Figure 3** shows the range of debt authorization capacity for new TRB authority at different limits based on fiscal year 2012 debt service appropriations of $292.8 million and the three year-average of unrestricted General Revenue Funds for fiscal years 2010 to 2012.

FIGURE 3
ESTIMATED TUITION REVENUE BOND AUTHORIZATION CAPACITY, FISCAL YEAR 2012

DEBT SERVICE LIMIT (PERCENTAGE)	ADDITIONAL DEBT SERVICE CAPACITY (IN MILLIONS)	ADDITIONAL DEBT AUTHORIZATION CAPACITY (IN BILLIONS)
1.00%	$89.0	$1.0
1.05%	$108.0	$1.2
1.10%	$127.1	$1.5
1.15%	$146.2	$1.7
1.20%	$165.3	$1.9
1.25%	$184.4	$2.1

SOURCE: Legislative Budget Board.

REVIEW OF DEBT SERVICE AMOUNTS FOR ISSUED BONDS

Under authority granted by the Texas Education Code, Chapter 55, public universities are allowed to issue their revenue bonds under a systemwide revenue financing system (RFS). Using a RFS, a university system leverages revenues from multiple institutions within the system. This practice allows the system to qualify for a higher bond rating than an individual institution may on its own, and reduces the cost of issuance by issuing a larger volume in a single issuance. RFS bonds can include more than one project, and a mixture TRB and non-TRB projects.

When a mixture of TRB and non-TRB projects are included in a system's RFS issuance, the official bond documents do not always distinguish TRB-related information from non-TRB information. The lack of clear distinction between TRB and non-TRB debt hinders the Legislature's ability to review and validate debt service appropriations requests.

The Bond Review Board (BRB) is the state agency responsible for collecting and analyzing information on state and local debt. To improve its monitoring of TRB debt, in 2002 the agency began requiring institutions and the Texas Public Finance Authority (TPFA), which issues for several smaller institutions, to submit their post-issuance, final bond transaction reports and semi-annual issuer reports with TRB debt outstanding and debt service separated from non-TRB reports. To separate the TRB from non-TRB debt service, institutions have their financial advisors run amortizations on each bond issuance for both debt types.

As part of the appropriations process, institutions submit their requests for TRB debt service appropriations in their legislative appropriation requests (LARs). LARs include requests for debt service on issued bonds. Institutions also provide estimates for debt service on unissued bonds, which may include existing, unissued debt authority and exceptional items contingent upon new debt authorizations. Legislative Budget Board (LBB) staff review these requests but historically have not had documentation that would allow independent verification of the debt service amounts requested.

To ensure that the LBB can monitor and verify the debt service amounts for issued TRBs, Recommendation 2 would include a rider in the introduced 2014–15 General Appropriations Bill to require BRB to submit its final bond transaction reports and semi-annual issuer reports for public institutions of higher education to the LBB, including separate debt outstanding and debt service schedules. BRB would not be required to modify its existing reporting practices, only to share any copies of institution-related final bond transaction reports and semi-annual issuer reports with the LBB on a periodic basis. This process change would provide the LBB with more accurate information to develop TRB appropriation recommendations and to monitor TRB debt service without requiring additional reporting by the institutions.

LAPSING UNUSED DEBT SERVICE APPROPRIATIONS

For any state agency or institution that receives debt service appropriations for unissued bonds, appropriation amounts are based on estimated debt service payments. Once bonds are issued, interest rates, term, and payment structure can affect the actual annual debt service that an issuer must pay. To avoid a situation where there is not sufficient appropriations to cover the debt service, during the appropriations request process issuers will often use assumptions about higher interest rates and other features that may result in an appropriation that exceeds the amount required to pay annual debt service.

Issuer assumptions affect the estimated debt service payment and the related appropriations request for any unissued or new debt authority. TPFA issues bonds for multiple bond programs and client agencies, including Midwestern University and Texas Southern University. For the Eighty-third Legislature, 2013, TPFA directed client agencies to use a 6.0 percent interest rate assumption for tax-exempt bonds for the 2014–15 biennium. Also, as part of the LAR process, institutions and university systems also assumed 6.0 percent interest rates for exceptional items relating to potential new TRB debt authority.

In system and institution issuances during fiscal years 2011 and 2012, interest rates were generally lower than 6.0 percent. **Figure 4** shows recent bond issuances and related interest rates. Most systems issue serial bonds, but they also use term bonds. Serial bonds have some portion of the debt maturing every year, while term bonds have a single maturity period. Each maturity has its own interest rates, so a single bond issuance will typically have a range of interest rates over the life of the bond.

As shown in **Figure 4**, all but one of the 12 issuances had interest rates that were less than 6.0 percent. The exception is the Texas Southern University issuance from January 2011, which had an interest rate ranging from 4.00 percent to 6.75 percent. The maturities with interest rates of 6.00 percent or higher all mature in 2023 or later. Also, among the universities included in **Figure 4**, all but Texas Southern University had a credit rating of AA- or higher, whereas Texas Southern had a credit rating of BBB. Higher credit ratings result in lower interest rates.

The use of more accurate interest rate information in LARs could result in debt service appropriations requests that are more consistent with actual debt service payments. For example, institutions' LAR exceptional item requests for the 2014–15 biennium totaled $4.1 billion in new authority, resulting in estimated debt service needs of $683.7 million. Assuming level debt service and a 20-year term, the difference between a 5.0 percent and 6.0 percent interest rate on $4.1 billion in new authority totals $28.8 million per year. In this example, the Legislature could appropriate those funds for another purpose.

At least one state issuer, TPFA, has had several biennia where the agency voluntarily disclosed excess appropriations for debt service and lapsed, or returned the unused related appropriations of General Revenue Funds. These lapses by TPFA include $100.1 million for Proposition 4 and cancer bonds at the end of the 2010–11 biennium, and a projected lapse of $22.6 million at the end of the 2012–13 biennium for Proposition 4 bonds.

During fiscal year 2010, five university systems and one independent institution lapsed appropriations of $50.4 million in General Revenue Funds for tuition revenue bond debt service for the 2010–11 biennium. As part of the LAR instructions for the biennium, state agencies were asked to make reductions of 5 percent. One university system

FIGURE 4
INTEREST RATES ON UNIVERSITY BOND ISSUANCES, 2011 TO 2012

INSTITUTION/ UNIVERSITY SYSTEM	BOND CLOSING DATE	INTEREST RATES	NOTES
Midwestern State University	10/09/2012	2.00% to 2.25% – Series A	Series A – Tax-exempt
		0.50% to 3.24% - Series B	Series B – Taxable
Texas A&M University System	07/18/2012	4.00% to 5.00% – Series A	Series A – Tax-exempt
		0.58% to 3.58% – Series B	Series B – Taxable, includes Term Bond
Texas Woman's University	06/05/2012	2.00% to 4.00%	Tax-exempt, includes Term Bond
University of North Texas System	06/01/2012	2.00% to 5.00% – Series A	Series A – Tax-exempt
		0.55% to 4.05% – Series B	Series B – Taxable, includes Term Bond
University of Texas System	03/01/2012	2.00% to 5.00% – Series A	Series A – Tax-exempt
	03/21/2012	2.00% to 5.00% – Series B	Series B – Tax-exempt
Texas State University System	02/14/2012	2.00% to 5.00%	Tax-exempt
Texas Tech University System	02/14/2012	2.00% to 5.00% – Series A	Series A – Tax-exempt, includes Term Bond
		0.40% to 4.44% – Series B	Series B – Taxable, includes Term Bond
University of Houston System	12/29/2011	2.00% to 5.00% – Series A	Series A – Tax-exempt, includes Term Bond
		3.25% to 4.85% – Series B	Series B – Taxable, includes Term Bond
Texas A&M University System	03/15/2011	2.50% to 4.00% – Series A	Series A – Tax-exempt
	03/10/2011	3.00% to 5.50% – Series B	Series B – Tax-exempt, includes Term Bond
Texas Southern University	01/27/2011	4.00% to 6.75%	Tax-exempt, includes Term Bond

Note: All issuances are revenue bonds except for Texas A&M University's July 2012 issuance, which is an issuance of Permanent University Fund (PUF) General Obligation bonds.
Sources: Legislative Budget Board; Municipal Securities Rulemaking Board.

suggested returning excess TRB debt service appropriations as part of its 5 percent reduction. The system had used appropriations of General Revenue Funds in excess of regularly scheduled principal and interest payments to make additional principal payments. This use of funds can lower overall debt costs and create debt capacity for the system, but it was not the original purpose for the appropriation. In another case, appropriations were higher than needed for debt service due to the timing of issuance and project delays. If there are excess TRB debt service appropriations, the Legislature may want to direct how those funds should be used. Institutions could continue to use excess appropriations for extra principal payments, but it may be beneficial to the state for those funds to lapse and be available for other programs funded with General Revenue Funds. Five systems and three independent institutions reported a projected a $1.0 million lapse in unused TRB debt service appropriations for the 2012–13 biennium.

Within the 2012–13 General Appropriations Act, Rider 9, Section 6, in the Special Provisions Relating to Higher Education, relating to tuition revenue bond reimbursement expenditures, restricts their use to debt retirement. The rider requires any funds not used for debt retirement to be reverted to the General Revenue Fund at the end of each fiscal year. To maximize limited General Revenue Funds, Recommendation 3 would amend Rider 9, Section 6 of the Special Provisions Relating Only to Higher Education in the introduced 2014–15 General Appropriations Bill. The revised rider would require public institutions of higher education to lapse any funds that exceed the regularly scheduled principal and interest payment on tuition revenue bond debt service appropriations each fiscal year.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations would not have a direct fiscal impact to the state.

Recommendation 1, limiting TRB authorizations by capping annual debt service reimbursement, does not have a fiscal impact. Recommendations 2 and 3 are based on existing reporting and documentation practices at BRB and public institutions of higher education. They can be implemented within existing agency resources.

The introduced 2014–15 General Appropriations Bill includes a rider to implement Recommendation 2 and amends an existing rider to implement Recommendation 3.

MAXIMIZE THE CAPACITY OF NURSING EDUCATION PROGRAMS TO REDUCE THE SHORTAGE OF NURSES IN TEXAS

Texas faces a shortage of registered nurses that is projected to rise as baby boomers age and their demand for healthcare increases. The Texas Board of Nursing projects that Texas will need an additional 71,000 full-time-equivalent registered nurses by 2020. Since 2001, the Texas Legislature has passed legislation to address the nursing shortage. The legislation provided incentives for increasing enrollment and graduation rates in nursing programs, providing research on the nursing workforce, and funding additional efforts including programs to promote innovations in nursing education. Collectively, the programs related to these efforts were appropriated approximately $144 million in General Revenue Funds since fiscal year 2003.

From fiscal years 2006 to 2012, the Texas Board of Nursing approved 39 new nursing programs at public, private, and career institutions. Despite these new programs, 41 percent of qualified applicants to initial registered nurse licensure programs were denied admission due to space or faculty shortages. Faculty shortages in nursing programs is a major factor in determining enrollment capacity and increasing graduates. In a 2011 survey, 71 percent of nursing programs in Texas indicated that a limited qualified applicant pool was a major barrier to faculty recruitment. Increased regional coordination with all higher education sectors, a standardized online application for students, and financial incentives for potential nursing faculty would enable programs to share limited resources, increase the pool of nursing faculty, and increase the capacity of nursing education programs.

FACTS AND FINDINGS

- Of the 39 new nursing programs approved by the Texas Board of Nursing since 2006, almost half are at career schools. The agency has 22 additional program proposals pending, and many of those institutions have never offered nursing programs.
- In 2011, 88 of the 105 initial registered nurse licensure programs turned away approximately 11,000 qualified applicants. Although 15,700 qualified applicants were offered admissions, 1,725 available seats went unfilled. In 2011, only 17 programs offered admissions to all students with qualified applications.
- Registered nursing programs report that the lack of clinical spaces budgeted, faculty positions, and qualified faculty applicants are frequent issues that prevent nursing programs from admitting qualified applicants.
- The Professional Nursing Shortage Reduction Program, Hospital-Based Nursing Education Partnership Program, and Nursing Innovation Grant Program include incentives to increase nursing faculty through stipends, partnerships, and innovative methods. The state's Graduate Nurses' Education Loan Repayment Program was established by statute in 1989.
- As of September 2011, there were 149.5 full-time-equivalent faculty vacancies in professional nursing education programs in Texas.

CONCERNS

- For-profit career schools are not members of the statutorily established Higher Education Regional Councils. Excluding career schools from these councils limits their ability to ensure the efficient use of clinical, fiscal, and human resources, prevent duplicative programs, and improve inter-institutional cooperation for nursing education programs.
- Unlike state medical and dental education programs, nursing education programs do not use a common application form, which would help ensure that all seats in initial registered nurse licensure programs are filled.
- Although several state incentives are available to increase nursing faculty, a gap in available qualified faculty remains. The state's Graduate Nurses' Education Loan Repayment Program has never received state funding.

RECOMMENDATIONS

- **Recommendation 1:** Amend statute to include representatives from for-profit degree granting career colleges and schools with degree granting programs on Higher Education Regional Councils statewide.

- ♦ **Recommendation 2**: Amend statute to include admissions and available scholarships to nursing education programs at public two-year and four-year institutions as part of ApplyTexas, the statewide electronic common admission application form.
- ♦ **Recommendation 3:** Amend statute to authorize monies deposited in the Physicians Education Loan Repayment Program Account (General Revenue–Dedicated Funds) to fund the Graduate Nurses' Education Loan Repayment Program.
- ♦ **Recommendation 4:** Include a contingency rider in the 2014–15 General Appropriations Bill to appropriate $1.1 million from the Physicians Education Loan Repayment Program Account (General Revenue–Dedicated Funds) for the Graduate Nurses' Education Loan Repayment Program. This appropriation would be contingent on authorizing the use of these funds for nursing loan repayment programs.

DISCUSSION

In Texas, the professional title "registered nurse" (RN) may be used only by individuals who:

- graduated from an accredited diploma program, associate degree (ADN) program, or a bachelor's degree (BSN) nursing program;
- passed a national comprehensive examination for registered nurses (NCLEX-RN); and
- are licensed by the Texas Board of Nursing (BON).

After RNs qualify for nursing practice, they may accept a position in a hospital, clinic, or other healthcare setting. In these different settings, an RN may progress from graduate nurse, to staff nurse, and to nurse manager. An RN with a baccalaureate degree may also take advanced courses at the master's level to qualify for a more specialized nursing role (e.g., nurse educator, nurse administrator, nurse practitioner, or a clinical nurse specialist).

In addition to the BSN, ADN, or diploma received by RNs, another undergraduate-level program available is the licensed vocational diploma in nursing. Licensed vocational nurses (LVNs) are important because of their contributions to care in long-term care facilities and nursing homes. LVNs receive a diploma after completion of a 12-month program. To become an LVN the student must pass a national comprehensive examination for practical nurses (NCLEX-PN) and be licensed by BON. According to the U.S. Health Resources and Services Administration (HRSA) in 2010, some LVNs continue their education to become RNs; approximately 17.9 percent of RNs were once licensed as LVNs.

The BON is the chief regulatory agency in Texas for both LVNs and RNs and is responsible for approving nursing programs, licensing new graduates and nurses moving to Texas from other states and countries, investigating complaints against nurses, and taking disciplinary action against licensees.

According to the Texas Higher Education Coordinating Board, Texas has experienced a nursing shortage that is different from shortages of the past and, therefore, may have a more long-term effect on the availability and quality of healthcare delivery. In the past, nursing shortages have been caused primarily by market factors such as levels of healthcare reimbursement. The current shortage is driven primarily by demographic changes. General population growth, the increasing proportion of persons over age 65, and advances in medical technology are expected to accelerate the demand for patient care services and, thus, the need for new nurses. The 2012 Bureau of Labor Statistics' *Employment Projections 2010–2020* lists the RN nursing workforce as one of the occupations that will add the most positions by 2020. Nationally, it is expected that the number of practicing nurses will grow from 2.74 million in 2010 to 3.45 million in 2020, an increase of 712,000, or 26 percent. An additional 495,500 nurses will be needed to replace nurses who retire, bringing the total demand for nurses due to population growth and replacements to 1.2 million by 2020.

Texas began addressing the nursing shortage in 2001, through the passage of the Nursing Shortage Reduction Act, which provided incentives for nursing programs to enroll and graduate more nurses. The Seventy-eighth Legislature, Regular Session, 2003, established the Texas Center for Nursing Workforce Studies (TCNWS) as a resource for data and research on the nursing workforce in Texas. From fiscal years 2003 to 2012, the Legislature funded additional efforts to address the nursing shortage including programs to promote innovations in nursing education and minority health research. These programs were appropriated approximately $144 million of General Revenue Funds in this period.

The TCNWS projected the number of new initial licensure graduates needed in the state, using a supply-demand model

the U.S. Health Resources and Services Administration developed. **Figure 1** shows the projected need for new initial licensure nursing graduates in Texas through 2020. This data is based on a simple regression formula of actual graduation data reported from 2002 to 2007. The data show that from 2007 to 2012, the state will need to double the number of initial licensure nursing graduates to begin to meet the need for new nurses. By 2020, that 2012 amount will need to almost double.

FIGURE 1
PROJECTED NEED FOR INITIAL LICENSURE GRADUATES IN TEXAS, FISCAL YEARS 2007 TO 2020

YEAR	BASELINE OF GRADUATES	TOTAL RN GRADUATES NEEDED	ADDITIONAL GRADUATES NEEDED
2007	7,031	N/A	N/A
2008	7,553	N/A	N/A
2009	8,031	N/A	N/A
2010	8,510	9,717	1,207
2011	8,989	12,065	3,076
2012	9,468	14,593	5,125
2013	9,946	15,199	5,253
2014	10,425	17,117	6,692
2015	10,904	17,777	6,873
2016	11,382	19,383	8,001
2017	11,861	20,073	8,212
2018	12,340	23,302	10,962
2019	12,819	24,085	11,266
2020	13,297	24,870	11,573

Source: Texas Center for Nursing Workforce Studies.

Since 2001, the Texas Legislature has provided increased funding to build enrollment capacity and improve student graduation rates in the state's 105 initial RN licensure programs. Texas has five major types of initial RN licensure programs for nurses:

- diploma programs are traditionally hospital-based and require three years of study;
- associate degree programs (ADN) traditionally require prerequisites (i.e., anatomy and physiology) plus two years of study at a community college;
- baccalaureate degree programs (BSN) traditionally require four years of study with nursing curricula usually occurring during the last two years at a university or health-related institution;
- alternate entry degree programs are normally accelerated, second-degree programs and are usually offered at a university or health-related institution; and
- licensed vocational nursing to registered nurse programs (LVN-RN) traditionally require one year of study after a student has completed a certificate program and is licensed as vocational nurse (LVN). The LVN then completes a curriculum leading to licensure as a RN. Most of the LVN-RN programs are offered as LVN-ADN programs at community colleges, and program completers are reported as ADN graduates.

Graduates from these different programs take the same national licensure exam and often earn the same starting salary at healthcare facilities.

Figure 2 shows the distribution of these types of programs and the percentage of degrees conferred in 2011.

FIGURE 2
INITIAL RN LICENSURE PROGRAMS IN TEXAS, 2011

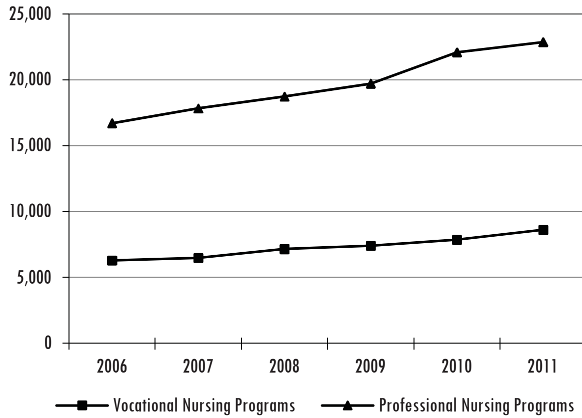
PROGRAM TYPE	NUMBER OF PROGRAMS	PERCENTAGE OF 2011 GRADUATES
Diploma	1	1%
Associate Degree (LVN-ADN, ADN)	66	63%
Baccalaureate Degree (BSN)	37	35%
Alternate Entry Master's Degree	1	1%
Total Programs	**105**	**100%**

Source: Texas Center for Nursing Workforce Studies.

Enrollment in professional or RN and LVN programs has increased. TCNWS reports that RN enrollment increased from 16,711 students to 22,866, or 37 percent, from 2006 to 2011. LVN enrollment increased from 6,295 to 8,612, or 37 percent, during the same period. **Figure 3** shows the trend in nursing program enrollment from fiscal years 2006 to 2011.

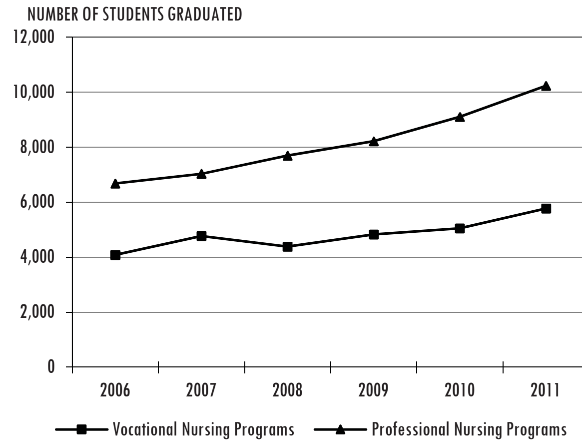
Graduation rates from RN and LVN programs continue to increase. TCNWS reports that the number of RN program graduates increased from 6,674 to 10,228, or 53 percent, from fiscal years 2006 to 2011. The number of LVN program graduates increased from 4,082 to 5,773, or 41 percent, during the same period. **Figure 4** shows the trend in nursing program graduations.

FIGURE 3
NURSING PROGRAM ENROLLMENT TREND
FISCAL YEARS 2006 TO 2011



SOURCE: Texas Center for Nursing Workforce Studies.

FIGURE 4
NURSING PROGRAM GRADUATION TRENDS
FISCAL YEARS 2006 TO 2011



SOURCE: Texas Center for Nursing Workforce Studies.

After graduation, RN and LVN candidates must pass the national comprehensive exam, NCLEX. Once applicants meet all eligibility requirements to take the NCLEX, they must take the examination within four years. The NCLEX examination pass rate for each nursing program is determined based on the examination results for first-time candidates testing during the specified examination year. This information provides an indicator of the effectiveness of the nursing program. **Figure 5** shows the trend in the number of first-time candidates taking the NCLEX examination and the pass rates by examination year.

From 2006 to 2011, the NCLEX pass rate for first-time candidates from RN programs and LVN programs decreased 4 percentage points. The number of RN first-time candidates increased by 61 percent, nearly double the amount of LVN first time candidate growth of 32 percent, for the same period.

According to TCNWS, the demand for RNs in Texas will increase by 86 percent from 2005 to 2020, while the supply will grow by only 53 percent with the current strategies in place. These numbers translate to a shortage of approximately 71,000 full-time-equivalent nurses. The overall number of nurses in Texas is expected to increase as the number of new nursing programs and existing programs graduate students.

FIGURE 5
NCLEX EXAMINATION PASSING RATE TRENDS FOR INITIAL LICENSURE NURSING PROGRAMS, EXAM YEARS 2006 TO 2011

	PROFESSIONAL REGISTERED (RN) NURSING PROGRAMS			LICENSED VOCATIONAL (LVN) NURSING PROGRAMS		
EXAM YEAR	FIRST TIME CANDIDATES	FIRST TIME CANDIDATES PASSED	PERCENTAGE OF FIRST TIME CANDIDATES PASSED	FIRST TIME CANDIDATES	FIRST TIME CANDIDATES PASSED	PERCENTAGE OF FIRST TIME CANDIDATES PASSED
2006	6,022	5,468	91%	4,440	4,043	91%
2007	7,001	6,314	90%	4,886	4,362	89%
2008	7,521	6,819	91%	5,032	4,461	89%
2009	8,146	7,413	91%	5,488	4,840	88%
2010	8,912	7,959	89%	5,627	4,990	89%
2011	9,711	8,452	87%	5,877	5,097	87%

SOURCE: Texas Board of Nursing.

Although Texas has already implemented multiple strategies via a variety of partnerships and legislative initiatives to meet demand by 2020, additional support is necessary to achieve these goals.

NEW NURSING PROGRAM GROWTH IN TEXAS

From fiscal years 2006 to 2012, BON approved 39 new nursing programs. Almost half of the programs were at for-profit career schools. According to BON, there are 22 additional program proposals pending, and many of those institutions have never offered nursing programs. **Figure 6** shows the number of initial LVN and RN licensure programs by offering entity. The proliferation of LVN programs can be attributed to the increased participation of for-profit career schools. The proliferation of RN programs has been due to a variety of program settings, including the increased participation of for-profit career schools.

FIGURE 6
INITIAL LICENSURE PROGRAMS AS OF APRIL 2012
LICENSED REGISTERED NURSING AND VOCATIONAL NURSING PROGRAMS

GOVERNING ENTITY	NUMBER OF PROGRAMS	DIPLOMA/ ASSOCIATE DEGREE PROGRAMS	BACCALAUREATE DEGREE PROGRAMS
Public Colleges/ Universities	72	59	24 + 1 Alternate Entry MSN
Private Colleges/ Universities	1	1	12
Career Schools	20	7	3
Military Based	1	0	0
Hospital Based	3	1	0
Total	**97**	**68**	**40**

Source: Texas Board of Nursing.

One of the reasons for the entry of more career schools into nursing education is the change in the Texas Higher Education Coordinating Board (THECB) regulations, which allow for recognition of a greater number of accreditation agencies approved by the U.S. Department of Education. The increasing use of online nursing education from other states also affects nursing education in Texas. However, since there is no regulatory oversight from BON over out-of-state programs, the effect is difficult to quantify.

Texas has a significant number of nursing programs clustered in regions of the state as shown in **Figure 7**. This increases the potential for overlap and duplication in common administrative tasks and instruction. According to BON, private higher education institutions and career schools tend to have few seats per program, which may also contribute to inefficient use of clinical, fiscal, and human resources in their geographic region.

HIGHER EDUCATION REGIONAL COUNCILS

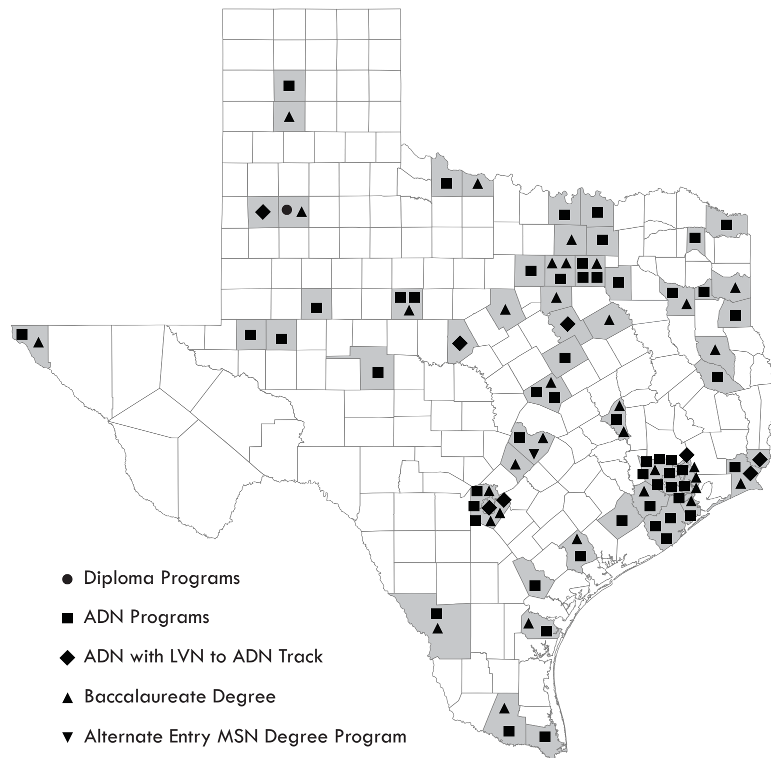
Systematic regional processes can help link and leverage program resources to serve more students with fewer resources. Regionalization is a key component in the THECB's 2008 report, *A New Curriculum Model for Initial Licensure Programs* and the Texas Team's *A Strategic Plan for the State of Texas To Meet Nursing Workforce Needs of 2013*. In both reports, regionalization is a primary mechanism to ensure expanded program capacity while maintaining local control and maximizing limited resources.

The 2009 Texas Team report also found that expanding nursing education programs and an increasing number of students are experiencing overcrowded and congested clinical sites. Regionalization can increase access to clinical resources.

There are 10 Higher Education Regional Councils (HERCs) in Texas. Each HERC consists of the universities, health-related institutions, technical colleges, and Lamar State Colleges within the region. HERCs correspond to the 10 Uniform State Service Regions established pursuant to the Texas Education Code, Section 51.662. The purpose of HERCs is to advise the THECB Commissioner on appropriate policies and procedures for the effective state-level administration of off-campus lower-division instruction. Off-campus lower-division instruction includes nursing education and clinical coursework. HERCs are also expected to help facilitate inter-institutional cooperation and to encourage excellence in the conduct of instruction.

The membership of each HERC is comprised of the presidents or designated representative of each public and independent institution with its main campus within the region. A council chair is elected by the members. The term of service for the council chair is also determined by the members. Regional councils are expected to meet annually each spring to perform their designated duties. Any business that arises during other times of the year may be conducted electronically at the discretion of the council chair.

FIGURE 7
REGISTERED NURSING PROGRAMS APPROVED MARCH 2010



Source: Texas Board of Nursing.

Universities, health-related institutions, public technical colleges, and Lamar state colleges submit all proposed off-campus lower-division courses proposed in the region for the HERC's review. Public community colleges submit all off-campus lower-division courses proposed for sites outside their service areas for HERC review. If a dispute arising from off-campus or electronic delivery of lower-division courses, institutions may appeal first to the regional council, and then to the THECB commissioner and the THECB board.

Private institutions of higher education are also HERC members, but filing off-campus lower-division course delivery plans with HERCs is not required. For-profit career schools with degree-granting programs are not included as HERC members.

Recommendation 1 would amend the Texas Education Code to include representatives from career schools with degree-granting programs on the HERC in the area in which they are located. Including career schools with degree granting programs as members of the HERCs would provide opportunities for a unified, strategic approach to address the nursing shortage and to overcome nursing education capacity issues in order to meet the state's needs.

MAXIMIZE CAPACITY IN INITIAL RN LICENSURE PROGRAMS

Despite additional programs and the efforts of existing programs to increase enrollment in fiscal year 2011, a gap remains between the number of qualified applicants and those who were offered admission. In fiscal 2011, 88 of the 105 nursing education programs denied admission to approximately 11,000 qualified applicants. Registered nursing programs report that the lack of faculty positions, clinical spaces, and qualified faculty applicants are frequent issues that prevent nursing programs from admitting qualified applicants. **Figure 8** shows qualified applicants and admissions to nursing programs in Texas, by year. Although more than 15,000 qualified applicants were offered admission and some qualified applicants were denied admission, more than 1,700 available seats still went unfilled due to duplicate applications and a lack of coordination between the programs. Better coordination of the application and

FIGURE 8
QUALIFIED APPLICATIONS AND ADMISSIONS TO INITIAL REGISTERED NURSE LICENSING PROGRAMS
FISCAL YEARS 2001 TO 2011

FISCAL YEAR	QUALIFIED APPLICATIONS	OFFERED ADMISSION	QUALIFIED BUT DENIED ADMISSION	PERCENTAGE QUALIFIED BUT DENIED ADMISSION
2001	11,646	8,672	2,974	25.5%
2002	12,253	9,457	2,796	22.8%
2003	15,166	9,147	6,019	39.7%
2004	22,325	10,802	11,523	51.6%
2005	22,843	10,593	12,250	53.6%
2006	22,885	10,766	12,119	53.0%
2007	19,035	11,270	7,765	40.8%
2008	21,383	12,338	9,045	42.3%
2009	21,137	12,403	8,734	41.3%
2010	26,053	14,836	11,217	43.1%
2011	26,633	15,700	10,933	41.1%

Source: Texas Center for Nursing Workforce Studies.

admissions process among nursing programs could help ensure that all seats are filled.

APPLICATIONS PROCESS FOR NURSING EDUCATION PROGRAMS

Unlike state medical and dental education programs, nursing education programs do not use a standardized online application to fill all seats in initial licensure programs. In 2011, only 17 programs offered admissions to all students with qualified applications. According to TCNWS, student candidates for admission may apply and be accepted by more than one nursing program; therefore, these data may represent some duplicated counts of individuals. THECB estimated during 2009 approximately 10 percent of the qualified applicants who were denied admission submitted more than one application.

Lack of application systems result in duplication of applications, vacant admission slots, and the inability to use resources to assess, track and retain "at risk students." According to the 2009 Texas Team report, Texas funded two pilots through the 2008–2009 Nursing Innovation Grant Program to address both a common application portal and a robust retention portal. In January 2009, the West Texas Nursing Education Consortium (WTNEC) launched a standardized online application for entry into the regional WTNEC programs (associates degree in nursing and bachelor of science in nursing). The goal of this new application process was to decrease and possibly eliminate student vacancy rates in member schools as well as reduce the resources needed by each school for the admission process. The online application system allowed prospective students to apply through an admission portal. Students could choose the nursing program(s) they wanted to attend, but they were also made aware of possible openings in other participating schools. The admission portal also saved potential students time and money by submitting one application.

In 2010, the American Association of Colleges of Nursing (AACN) Nursing Common Application System (NursingCAS) was established with assistance from WTNEC, and other state and national partners. NursingCAS serves as an important mechanism for addressing the national shortage of nurses and faculty by helping to fill all vacant seats in participating schools of nursing. Institutions participating in NursingCAS gain direct access to a larger pool of nursing school applicants and the ability to announce when program space is available at any point during their regular application cycle. Sixteen of the 105 Texas nursing programs participate in the NursingCAS. Applicants to entry-level nursing programs pay NursingCAS $45 to submit their first application and $30 for subsequent applications. Applicants to traditional graduate programs pay $65 for the first application, and $35 for those subsequent.

ONLINE APPLICATIONS SYSTEMS USED IN TEXAS

Texas has two statewide electronic common application systems to facilitate higher education enrollment, the Texas Medical and Dental School Application Service (TMDSAS) and ApplyTexas. The TMDSAS is the online application system for applicants to the first-year entering classes at all of

the public medical, dental and veterinary schools in the state of Texas. TMDSAS simplifies the application process for both the applicants and the participating schools. One standardized application is provided, saving students from completing separate applications for each the participating schools. The TMDSAS participating schools benefit by receiving uniform information on all applicants and by designing the questions on the application. TMDSAS serves only as an information clearinghouse and does not influence the schools' review of the application or their selection of applicants to interview and accept.

Applicants to public Texas medical schools must apply through TMDSAS, unlike schools in other U.S. states which use the American Medical College Application Service (AMCAS) or the American Association of Colleges of Osteopathic Medicine Application Service (AACOMAS). For the 2010 application cycle (for entry year 2011), the cost for Texas residents to apply to schools using TMDSAS was $75 for the first school and $10 for each additional school.

In 1997, the Seventy-fifth Legislature passed legislation, which authorized the State of Texas Common Application for Admission to Texas Public Universities. This legislation allows students to complete one standardized application and submit it to multiple universities. An advisory committee of university admissions officers and high school counselors developed the form in October 1997. THECB adopted rules for the common admission application in July, 1998. As mandated by the Texas Education Code, the form was ready for use by applicants for admission to Texas public universities for the 1999–2000 academic years. Community college districts were added to ApplyTexas in 2005; however, they are not statutorily required to participate.

The Texas Common Application was later renamed ApplyTexas. The goal of ApplyTexas is to offer a centralized means for both Texas and non-Texas students to apply to the many postsecondary institutions available in Texas. Students can use ApplyTexas for admission to any Texas public university, as well as a few participating community and private colleges. Students can also apply for scholarships, housing, and some graduate programs. Changes to ApplyTexas are made by an advisory committee consisting of two-year, four-year, and private institutions. The committee meets at THECB approximately four times a year between September and May.

The system is administered through an agreement between THECB and University of Texas at Austin. Participating institutions are charged a prorated fee based on prior year enrollment for the service by THECB. Institutions can charge application fees to prospective students to cover the costs. In fall 2012, participating institutions charged undergraduate students (resident and non-resident) application fees ranging from $0 to $90.

Recommendation 2 would amend the Texas Education Code to include admissions and available scholarships to nursing education programs at public two-year and four-year institutions as part of ApplyTexas. Institutions would benefit from the efficiencies gained by standardizing the nursing application process and having real-time access to pre-screened and verified applicant data online. Institutions would also be able to select from a wider, more diverse pool of students, which will be helpful in meeting recruitment goals. In terms of benefits to the profession, a centralized online application process could provide accurate data needed to identify workforce trends and inform public policy decisions. The comprehensive data set that results from having a central entry point into registered nursing programs could assist with developing workforce projections, identifying employment patterns, and tailoring recruitment strategies to reach under-represented populations in nursing.

INCREASE THE FACULTY POOL FOR INITIAL RN LICENSURE PROGRAMS

The shortage of nurse faculty is one cause of the current nursing shortage. Without additional faculty to teach more incoming nursing students, the shortage will continue. According to a Special Survey on Vacant Faculty Positions released by American Association of Colleges of Nursing (AACN) in September 2011, 1,088 faculty vacancies were identified at 603 nursing schools with baccalaureate and/or graduate programs across the country. Besides the existing vacancies, schools cited the need to create an additional 104 faculty positions to accommodate student demand.

AACN data shows a national nurse faculty vacancy rate of 7.7 percent. Vacancy rates are calculated by dividing the number of vacant full-time-equivalent (FTE) faculty by the number of total FTE positions. Ninety-one percent of the vacancies were faculty positions requiring or preferring a doctoral degree. The top reasons cited by schools having difficulty finding faculty were a limited pool of doctoral-prepared faculty (31.3 percent) and noncompetitive salaries compared to positions in the practice arena (26.7 percent).

In 2011, 2,626 FTE faculty were reported working in initial RN licensure programs in Texas. There were 149.5 FTE vacancies for that same period. **Figure 9** shows that the total faculty vacancy rate in Texas was 6.2 percent. This rate is a slight increase above the 6 percent total faculty vacancy rate listed in 2010. According to TCNWS, 38 out of 105 or 36 percent of initial licensure programs reported no vacancies. The remaining programs reported a range of vacancy rates as high as 57 percent.

Several factors limit initial licensure programs from successfully recruiting faculty. In a 2011 TCWNS survey, 75 of the 105 (71 percent), of Texas nursing programs indicated that a limited qualified applicant pool was a major barrier to faculty recruitment. Seventy-one or 68 percent of programs indicated that competitive salary was a major barrier to recruitment, and 36 programs cited geographic location as a major barrier to faculty recruitment.

Master's and doctoral programs in nursing are not producing a large enough pool of potential nurse educators to meet the demand. Efforts to expand the nurse educator population are hindered because thousands of qualified applicants to graduate nursing programs are turned away each year. In 2011, AACN found that 13,198 qualified applicants were turned away from master's programs throughout the U.S., and 1,156 qualified applicants were turned away from doctoral programs. The primary reason for not accepting all qualified students was a shortage of faculty.

Since 2007, the total enrollment of Texas graduate nursing students increased by 16 percent, peaking in 2011 at 4,445. Enrollment in MSN-nursing educator programs represent 7 percent of all master-level enrollments. In 2011, there were 108 graduates from MSN-nursing educator programs and 50 graduates from Doctoral-nursing science programs. Despite enrollment increases in these programs, the number of graduates prepared to teach in initial licensure programs is not sufficient to alleviate current and future nursing faculty shortages.

Higher compensation in clinical and private-sector settings is diverting current and potential nurse educators away from teaching. According to the American Academy of Nurse Practitioners, the average salary of a nurse practitioner, across settings and specialties, is $91,310. By contrast, AACN reported in March 2011 that master's prepared faculty earned an annual average salary of $72,028.

Texas has implemented several key initiatives to address the nursing shortage. **Figure 10** shows four programs that include initiatives to increase nursing program faculty.

These programs were appropriated approximately $144 million of General Revenue Funds from fiscal years 2003 to 2012.

Ensuring sufficient numbers of faculty are available to prepare the next generation of RNs is critical to address the long-term shortage of nurses in Texas. Additional strategies states use to address their faculty shortage include loan forgiveness programs, faculty fellowships, and salary supplements. According to research, state loan forgiveness programs are an increasingly popular state remedy for healthcare workforce shortages, to increase the number of graduates in a certain field.

Fifteen states offer loan repayment or forgiveness programs for nurse educators. In 2006, Colorado's state Legislature passed two nurse-faculty shortage bills, which addressed both the financial barriers to graduate education and the salary differential for nurses working in academia versus practice. Modeled after an existing program for teachers in other disciplines, the Nurse Teacher Loan Forgiveness Program provides up to $20,000 in loan forgiveness for students pursuing master's or doctoral degrees in exchange for a five-year teaching commitment at a Colorado school of nursing. The Nursing Faculty Fellowship Program was created to assist nursing schools in filling faculty vacancies

FIGURE 9
TEXAS FACULTY VACANCY RATES BY PROGRAM TYPE, FISCAL YEARS 2002 TO 2011

	2002	2003	2006	2007	2008	2009	2010	2011
Diploma	2.1	10.8	3.9	3.9	5.2	0.0	0.0	0.0
ADN	6.3	6.2	7.5	7.1	7.2	6.1	7.4	6.8
BSN	7.6	5.1	4.9	4.9	4.8	4.8	5.0	5.9
Total	**6.7**	**5.9**	**6.0**	**5.8**	**5.9**	**5.3**	**6.0**	**6.2**

SOURCE: Texas Center for Nursing Workforce Studies.

FIGURE 10
TEXAS PROGRAMS TO REDUCE THE NURSING SHORTAGE SINCE 2001

PROGRAM	ESTABLISHED	PURPOSE
Professional Nursing Shortage Reduction Program	2001	To increase the number of graduates from professional nursing programs, the percentage of students in professional nursing programs that graduate within a reasonable time, and the number of graduates from master's and doctoral programs in nursing that join the faculty of a professional nursing program.
Nursing Innovation Grant Program	2001	To promote creative ways to educate, recruit, and retain nursing students and faculty.
Hospital-Based Nursing Education Partnership Program	2007	To increase the number of nurses in Texas by fostering innovation through partnership models, utilizing existing expertise and infrastructure to expand nursing education
Professional Nursing Shortage Reduction Program	2009 (revised)	To fund high-performing nursing programs through the Professional Nursing Shortage Reduction Program to hire faculty.

Source: Legislative Budget Board.

by providing fellowship payments of up to $10,000 per year for three years.

Other states are moving in the same direction. The Nebraska Legislature passed the Nurse Faculty Student Loan Act, which created a program to provide loans and loan waivers to nurses enrolled in masters or doctoral programs who intend to teach after graduation. The North Dakota State Board of Nursing operates a program called the Nursing Education Loan Program, which is available to nursing students in graduate and undergraduate programs. Doctoral students and nurses pursuing refresher courses may also apply for funding which can be repaid via nursing service in North Dakota after the program's end.

The purpose of the Virginia's Loan Repayment Programs is to increase access to primary care services in underserved areas. The Virginia Physician Loan Repayment Program is for primary care physicians and general psychiatrists only, while the Virginia State Loan Repayment Program is open to a broader spectrum of primary care practitioners to include primary care nurse practitioners, physician assistants, general dentists and dental hygienists. A retention study conducted in 2007, by a consultant suggested that the Virginia Loan Repayment programs had been very successful in improving both the short-term and long-term supply of physicians in underserved areas. In 2008, 57 active primary care physicians, nurse practitioners, physician assistants and general dentists were serving the Commonwealth through both Loan Repayment Programs. In addition, no loan repayment recipient was in default of fulfilling their service obligation. In 2010, the number of participants decreased to seven practitioners due to loss of state funding.

Texas established a Graduate Nurses' Education Loan Repayment Program in 2004, which has never received state funding. The purpose of the Texas Graduate Nurses' Education Loan Repayment Program is to promote the health educational needs and healthcare of Texans by encouraging qualified graduate professional nurses to serve as faculty in nursing education programs as advanced nurse practitioners. The Commissioner of Higher Education may authorize or cause to be authorized repayment of education loans made to an eligible professional nurse whom:

- has submitted the appropriate application to the board;
- has been serving on the nursing faculty of an eligible nursing program in a position requiring a graduate professional nurse for at least one year preceding loan repayment;
- has been practicing in Texas for at least one year immediately preceding loan repayment as an advanced nurse practitioner in a position that requires the services of an advanced nurse practitioner; and
- is currently serving on the nursing faculty of an eligible nursing program in a faculty position which requires a graduate professional nurse or is currently practicing in Texas as an advanced nurse practitioner in a position which requires an advanced nurse practitioner.

Total annual repayment to one or more eligible lenders may not exceed the applicant's unpaid principal and interest owed on one or more eligible loans, or $7,000, whichever is less. Education loan repayment(s) may be renewed annually upon successful completion of the application process, but the aggregate repayment amounts may not exceed $39,000.

Texas has a similar loan forgiveness program for physicians. The Eighty-first Legislature, Regular Session, 2009, passed legislation which dedicated a new stream of revenue for the Physician's Education Loan Repayment Program Fund (General Revenue–Dedicated Funds). At the end of the 2012–13 biennium, the account is expected to have an unobligated balance of $30 million. Statute limits the use of this fund for loan repayment assistance to physicians only. Recommendation 3 would amend the Texas Education Code, Section 61.5391, to allow monies deposited in the account be used to fund the Graduate Nurses' Education Loan Repayment Program. Recommendation 4 would include a rider in the 2014–15 General Appropriations Bill to appropriate $1.1 million from the Physicians Education Loan Repayment Program Account (General Revenue–Dedicated Account 5144) to the THECB to operate the Graduate Nurses' Education Loan Repayment Program.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations would have a cost of $1.1 million of the 2014–15 biennium.

Recommendation 1 allows new schools to participate on the regional councils and would have no fiscal impact for the 2014–15 biennium.

Recommendation 2 establishes a standardized online application process for nursing licensure programs. This process would build on existing infrastructure for other online application processes. Any costs would be minimal and could be absorbed through existing institutional resources.

Recommendations 3 and 4 would amend statute and provide funds for the Graduate Nurses' Education Loan Repayment Program. In 2011, there were 158 master and doctoral nursing education graduates. If 50 percent were funded each year during the biennium at $7,000 each, the total cost would be approximately $1.1 million. The five-year fiscal impact of these recommendations is shown in **Figure 11**.

FIGURE 11
FIVE-YEAR FISCAL IMPACT OF RECOMMENDATION 4
FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE–DEDICATED FUNDS (5144)
2014	($546,000)
2015	($546,000)
2016	($1,092,000)
2017	($1,092,000)
2018	($2,184,000)

Source: Legislative Budget Board.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

DEVELOP A COMPREHENSIVE STRATEGIC PLAN FOR ADULT BASIC EDUCATION TO MEET STATE WORKFORCE AND EDUCATION GOALS

More than 100,000 Texans receive literacy services and General Education Diploma preparation from federal, state, and locally funded adult eduction programs. These programs help participants obtain meaningful employment and transition to post secondary education. The 2003 state plan for improving adult basic education and the 2004 strategic plan addressed projected shortages in the state's skilled workforce. Both plans placed an increased emphasis on increasing participation in adult basic education programs, on workplace literacy, and on employment outcomes. Neither included strategies to achieve state goals beyond the basic requirements for adult education in federal law.

Texas' population trends indicate that the need for adult education services will increase. Providing effective adult education services for the millions of Texans who need them, both today and in the future, is a challenge for Texas. For the state to remain competitive, it must develop comprehensive strategies in adult education to address increasing educational and workforce demands, changing student needs, and new federal accountability standards. Developing a comprehensive strategic plan would enable the Texas adult education system to advance the state's education, economic, and workforce development goals.

FACTS AND FINDINGS

- ♦ According to the 2010 American Communities Survey, 3.8 million Texans qualified for adult basic education services. By 2040, a projected 7.9 million Texans will qualify for those services.
- ♦ A 2012 Texas Workforce Investment Council report estimated more than 247,000 students were served by federally funded and non-federally funded adult basic education providers in 2011. An estimated 26,546 to 42,305 individuals were on waiting lists.
- ♦ From fiscal years 2008 to 2011, Texas ranked below the national average GED pass rate for test takers. In 2011, Texas' average GED pass rate for test takers was 69.8 percent, and the national average was 72.2 percent.
- ♦ The number of students from federally funded adult education programs transitioning to postsecondary education and training declined steadily from 2007 to 2010.
- ♦ According to a 2010 Georgetown University report, two-thirds of the jobs created in the U.S. by 2018 will require some post-secondary education.

CONCERN

- ♦ The Texas Education Agency's 2003 long-range state plan for adult basic education is out-of-date and does not provide a foundation to guide decision-making by the myriad state agencies and programs involved in adult basic education beyond basic requirements in federal law. This impedes coordination by agencies and limits the state's effectiveness in meeting the state's education and workforce long-term needs.

RECOMMENDATION

- ♦ **Recommendation 1**: Include a rider in the introduced 2014–15 General Appropriation Bill to require the Texas Education Agency, in consultation with the Texas Workforce Investment Council, to develop and implement a comprehensive statewide strategic plan for adult education. This plan would address gaps in the adult education and literacy system, and would target specific state program goals and strategies.

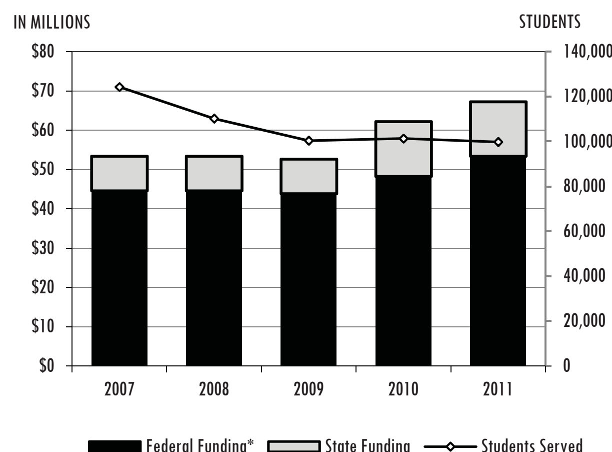
DISCUSSION

Texas' adult basic education (ABE) system provides individuals who are beyond the age of compulsory school attendance and who function at a less than secondary school completion level with basic literacy skills, English language proficiency, and preparation to obtain a secondary school credential or General Educational Development (GED) certificate. The 1999 Texas State Plan on Adult Education and Family Literacy was revised by Texas LEARNS in 2011 as a requirement to receive federal Adult Education and Family Literacy Act (AEFLA) funding. According to the plan, the mission of adult education and literacy is "to ensure that all adults who live in Texas have the skills necessary to function effectively in their personal and family lives, in the workplace, and in the community." A diverse set of partners, including the K–12 education system, community colleges, one-stop

centers, libraries, and community based organizations, work together to develop and provide ABE in Texas.

In program year 2010–11, the Texas Education Agency (TEA) awarded approximately $67 million in AEFLA and state matching funding to provide ABE to more than 99,802 adult Texans, as shown in **Figure 1**.

FIGURE 1
ADULT BASIC EDUCATION FUNDING AND STUDENTS SERVED
FISCAL YEARS 2007 TO 2011



*Includes Federal TANF.
Note: The student number reflected for program year 2011 does not include the Windham ISD incarcerated adults as reported to the U.S. Department of Education starting in 2011.
Source: Texas Higher Education Coordinating Board.

Since fiscal year 2003, Texas has initiated several efforts to improve ABE coordination, delivery, and performance. In 2003, TEA developed a state plan for adult basic education, *The Ten-Year State Plan for Improvement of Adult Education Efforts in Texas,* to address programmatic and efficiency barriers through a tri-agency approach including TEA, the Texas Higher Education Coordinating Board (THECB) and the Texas Workforce Commission (TWC). This plan discussed the extent of the need for adult education in Texas, compared Texas spending on ABE with that of other states, and provided a projected budget showing how increased spending could be used to reach more of those in need over the next 10 years. THECB, TEA and TWC approved the plan. However, budgetary constraints prohibited the plan's implementation.

In January 2004, the Office of the Governor directed staff from those three agencies to develop a plan to improve adult education that would increase efficiency and serve greater numbers of Texans using existing funding levels. During 2004, staff from THECB, TEA, TWC, and the Texas Workforce Investment Council (TWIC) developed a strategic action plan that addressed the goal of "increased results through improved performance." The present version of the plan represents a consensus by all three agencies on both broad strategies and specific methods for improving adult education within federal requirements. In 2007, the Legislative Budget Board's *Government Efficiency and Effectiveness* report found that the TWIC, TEA, and THECB strategic plans did not provide comprehensive linkages and coordinated strategies for encouraging postsecondary transitions for ABE students. As a result, legislation from the Eightieth Legislature, Regular Session, 2007, and Eighty-first Legislature, Regular Session, 2009, further promoted a tri-agency partnership between TEA, TWC, and THECB and directed the THECB to work with TEA to develop coordinated action plans to align adult education and postsecondary education.

ADMINISTRATION OF ADULT BASIC EDUCATION

TEA's Division of State Initiatives has administered the ABE program, since it was established in 1964. The original federal legislation, the Federal Economic Opportunity Act, placed the responsibility for adult education programs with state education agencies, and the Texas Education Code is consistent with federal legislation. Under an agreement with TEA, the Texas LEARNS program, housed in the Harris County Department of Education, provides nondiscretionary grant management functions, program assistance and other statewide support services to Texas Adult Education and Family Literacy providers. The TEA Grants Division is responsible for all discretionary, policy, and monitoring functions.

In addition to TEA, both TWC and THECB have an active role in ABE. TEA is responsible for ensuring that Texas adults receive a quality basic and secondary education. TWC is charged with overseeing and providing workforce development services to employers and job seekers in Texas. THECB coordinates services to undereducated adults through community and technical colleges. Some community colleges serve as fiscal agents for TEA and receive AEFLA funds to support basic education and literacy programs.

Nationally, adult education is governed by both state and federal law. Under Texas law, TEA is required to regulate adult and community education in the state by providing technical assistance and monitoring adult education programs to ensure compliance with federal and state statutes

and rules. TEA is also charged with ensuring continuous program improvement to ensure that programs are meeting state performance targets. State Board of Education rules outline the program delivery system governing how TEA provides program assistance, monitoring, and ensure compliance with federal requirements. Federal statute and regulations establish the source of federal support and distribution requirements pursuant to AEFLA enacted as Title II of the Workforce Investment Act (WIA) of 1998.

NEW CHALLENGES FOR ADULT BASIC EDUCATION

Recent years have brought many challenges to ABE including demographic shifts, education challenges, and workforce demands. According to the 2010 American Communities Survey, 3.8 million Texans qualified for adult basic education services, and it is projected that by 2040, 7.9 million Texans will qualify for those services. The 2012 TWIC report, *Research and Survey of Adult Education Providers in Texas,* estimated more than 247,000 students were served by AEFLA and non-AEFLA funded adult basic education providers in 2011. An estimated 26,546 to 42,305 individuals were on waiting lists.

The composition of the Texas population is also changing rapidly. From calendar years 2000 to 2040, the state's Hispanic population is expected to increase by approximately 182 percent. Of the 3.8 million Texans eligible for adult education services in 2010, 1.8 million were Limited English Proficient (LEP). It is projected that the LEP population in the state will increase to 3.4 million by 2040.

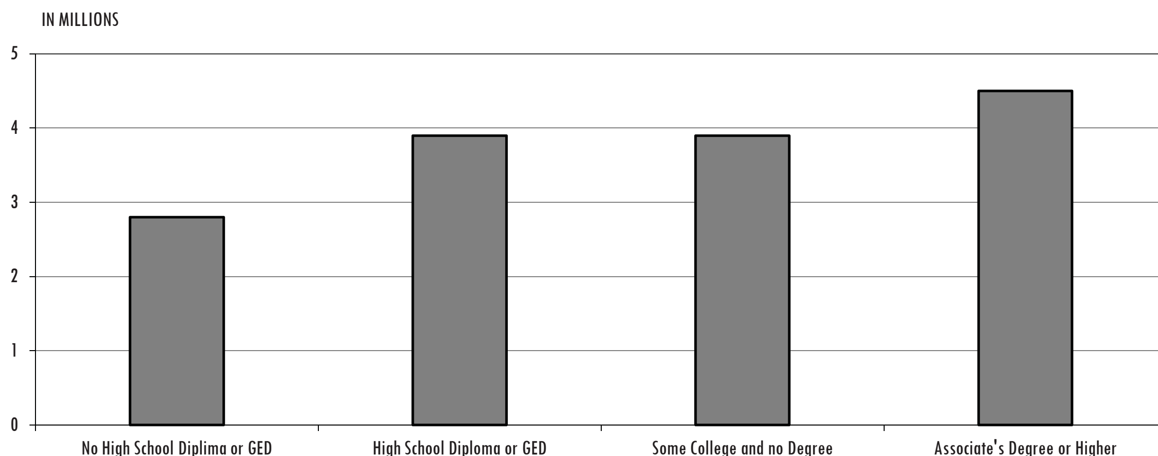
EDUCATION CHALLENGES

Texas faces challenges in educating a growing and diverse population. According to the U.S. Census, 2.9 million adults ages 18 to 64 lacked a high school diploma or GED in 2010, as shown in **Figure 2**.

From fiscal years 2008 to 2011, Texas ranked below the national average GED pass rate for test takers. In 2011, Texas' average GED pass rate for test takers was 69.8 percent, and the national average was 72.2 percent. Enrollment in federally funded AEFLA or non-federally funded ABE is not required for first-time GED test takers. From program years 2008 to 2011, the number of first-time GED test takers decreased from 41,054 to 38,250. However, GED awards to students from AEFLA-funded programs increased 7 percent during that same period. **Figure 3** shows the number of GED awards issued by program year, for first-time GED test takers and GED awards to students from AEFLA-funded programs.

A new GED test will be released nationwide in 2014 with a potential increased cost to students. The new GED assessment will replace the 2002 version in both content and in form. Students will be required to take the assessment on a computer and a paper version will only be available in limited instances. The GED cost to the state, newly set within the last year, is $24 per content area test, for a total of $120. States or local programs can determine how much of this cost

FIGURE 2
EDUCATIONAL ATTAINMENT OF TEXAS ADULTS AGES 18 TO 64, CALENDAR YEAR 2010



Source: The Working Poor Families Project.

FIGURE 3
GED AWARDS IN TEXAS
FISCAL YEARS 2008 TO 2011

YEAR	FIRST-TIME GED TESTERS	GED ISSUED	GED AWARDS (AEFLA)
2008	41,054	34,084	6,682
2009	41,250	33,683	6,377
2010	40,224	34,340	6,605
2011*	38,250	34,054	7,160

NOTE: Prior to 2010, TEA did not report GED awards issued to adults in Windham ISD. The increase of 555 awards in 2011 represents this group.
SOURCE: THECB, 2008–2011 GED Test Statistical Reports.

to pass on to students. TEA will no longer be required to administer the test directly. However, if it chooses to do so, TEA may continue to be responsible for administrative matters, such as issuing diplomas and transcripts, and it may have a role in selecting which programs can proctor the test. The content of the test is being updated to align with the Common Core Standards that 45 states have adopted and Virginia and Texas standards, which will make it academically more challenging. Texas did not adopt the Common Core Standards and requires a new high school equivalency test based on Texas College and Career Readiness (CCRS) standards.

Despite efforts to build a stronger college-going culture among learners served by AEFLA-funded ABE providers, there has been a steady decline in students transitioning from ABE to postsecondary education and training over the past four years. According to THECB, fewer than 6 percent of adult learners in federally funded ABE programs transitioned into postsecondary education in 2010, down from 7 percent in 2009. In the past four years, the percentage of adult education students transitioning into developmental education coursework increased from 43 percent in 2007 to 55 percent in 2010. During the same period, the percentage of students entering college, without developmental education, increased from 17 percent in 2007 to 25 percent in 2010. **Figure 4** shows the number of ABE students who enrolled in college and were placed in either developmental education, college-level, or in continuing education courses.

In **Figure 4**, "Number in College" is defined as those students with a goal of higher education that exited an AEFLA-funded program and enrolled in college within a year. According to TEA staff, all students initially enrolling in AEFLA-funded programs are formally asked about their educational future goals. Few ABE students enrolled in an AEFLA-funded programs report a short- or long-term goal of pursuing any type of postsecondary education.

Recent changes to federal student financial aid programs have increased the need for GED attainment. As of July 1, 2012, newly enrolled college students without a high school diploma or secondary school equivalent will no longer be eligible for federal student aid, due to the elimination of the "Ability to Benefit" options by Congress in December 2011. Congress eliminated the provision as part of the passage of the Consolidated Appropriations Act of Fiscal Year 2012, to fund federal programs for the remainder of fiscal year 2012 (October 2011 to September 2012). The "Ability to Benefit" option for federal financial aid eligibility has been a critical policy for supporting adult career pathway bridge programs and co-enrollment approaches being used across the state (adult basic skills and postsecondary courses). These models are often used to ease the transition of adult education students to postsecondary education.

WORKFORCE DEMANDS

The labor market demands a more educated workforce. According to the 2010 Georgetown University report, *Help Wanted: Projection of Jobs and Education Requirements through 2018*, two-thirds of the jobs created in the U.S. by 2018 will require some post-secondary education. The need for an

FIGURE 4
NUMBER OF ABE STUDENTS ENROLLING IN COLLEGE, DEVELOPMENTAL COLLEGE LEVEL, AND CONTINUING EDUCATION WITHIN A YEAR OF EXITING AEFLA FUNDED ADULT EDUCATION PROGRAMS, FISCAL YEARS 2007 TO 2010

YEAR	STUDENTS IN COLLEGE	STUDENTS IN DEVELOPMENTAL EDUCATION	PERCENTAGE IN DEVELOPMENTAL EDUCATION	STUDENTS IN COLLEGE LEVEL	PERCENTAGE IN COLLEGE LEVEL	STUDENTS IN CONTINUING EDUCATION	PERCENTAGE IN CONTINUING EDUCATION
2007	4,639	1,973	43%	795	17%	1,871	40%
2008	4,324	2,018	47%	785	18%	1,520	35%
2009	4,468	2,243	50%	921	21%	1,302	29%
2010	3,677	2,031	55%	935	25%	710	19%

SOURCE: Texas Higher Education Coordinating Board.

educated workforce in Texas is complicated by significant workforce shortages. According to the Office of the Governor's Competitiveness Council, Texas is expected to experience critical workforce deficits in higher education graduates as well as graduates from quality training and certification programs in nearly every industry cluster. TWC reports that the number of jobs in Texas is expected to increase by over 2 million from 2008 to 2018. Analysis of TWC projections for the 50 fastest-growing job categories in Texas reveals that 70 percent of these jobs will require some form of postsecondary education.

Education is not only increasingly essential for basic employment, it is also essential for economic prosperity and career advancement. According to the College Board report, *Education Pays 2010*, median earnings of bachelor's degree recipients working full-time year-round in 2008 were $55,700, or $21,900 more than the median earnings of high school graduates. A person earning a vocational certificate or associate's degree has higher lifetime earnings than a person holding only a high school diploma. The report also shows that a person who does not complete high school has 71 percent of the expected lifetime earnings relative to the expected lifetime earnings of a high school graduate.

NEW ACCOUNTABILITY FOR ADULT BASIC EDUCATION

In addition to a changed environment for ABE, federal adult education and literacy performance measure processes changed for all states in 2012. The major source of funds for Texas' ABE program is the federal AEFLA, enacted as Title II of the Workforce Investment Act of 1998. To receive AEFLA funds, states must provide at least a 25 percent match in non federal support, which may be provided in cash or "in kind." In fiscal year 2012, TEA received about $53 million in AEFLA funds and $13.3 million in General Revenue and "inkind" funds. Other programs with linkages to adult education and literacy are also funded by federal funds. These sources include the Food Stamps Employment and Training Program, Temporary Assistance for Needy Families/Choices, and Trade Adjustment Assistance, all administered by TWC.

When AEFLA was reauthorized in 1998, Congress made accountability for results a central focus of the law, setting out new performance accountability requirements for states and local programs that measure program effectiveness on the basis of student academic achievement and employment related outcomes. To define and implement the accountability requirements of AEFLA, the U.S. Department of Education's Office of Vocational and Adult Education (OVAE) established the National Reporting System (NRS), the federal adult education and literacy data system.

Since program year 2000, NRS has been the accepted accountability system for adult education in Texas. The state established a performance accountability system that meets NRS requirements. NRS data is the basis for assessing the effectiveness of states in achieving continuous improvement of adult education activities to optimize the return on investment of federal funds. AEFLA includes three core performance indicators:

- demonstrated improvements in the literacy skill levels in reading, writing, and speaking English, English language acquisition, and other literacy skills;
- placement in, retention in, or completion of post-secondary education, training, unsubsidized employment, or career advancement; and
- receipt of a secondary school diploma or recognized equivalent.

The new federal accountability standards require all state agencies that administer AEFLA funds to achieve core outcomes that are tracked and reported to the NRS. Each year, state adult education and literacy offices negotiate annual performance targets for these core outcomes with the OVAE. The negotiations are based on a continuous improvement model required in federal statute in which states must maintain or improve their previous year's performance levels.

The new outcomes are divided into two groups. The first is focused on increased educational functioning levels among those who attend adult education and literacy classes. The second group is focused on follow-up measures that assess whether individuals who participated in and then exited from adult education programs get or keep a job, earn a secondary credential, or enroll in postsecondary education or training. According to TEA staff, all state agencies and local ABE providers are required to make changes to track these data elements. Also, individual providers of adult education are now required to track student outcomes based on cohorts of students, not each individual student. These changes to performance expectations are not reflected in Texas 2003 strategic plan for adult basic education.

Before 2012, NRS required that states report on the follow-up measures of entered and retained employment, attainment of a secondary credential and entry into postsecondary

education or training for students who set these outcomes as goals for their participation. Effective July 1, 2012, NRS discontinued the use of goal-setting as a means to identify students to track attainment of the follow-up outcomes. Instead, NRS will require states to automatically report the follow-up measures for all students who meet certain criteria for each measure. This automatic cohort designation will vary according to each follow-up measure.

Texas' population trends suggest that the need for adult education services will increase. Providing effective adult education services for the millions of Texans who need them, both today and in the future, is a challenge for Texas. Changing student needs, increasing educational and workforce demands, and new federal accountability standards will require new strategies for the state to maintain a competitive edge. In recent years, state agencies have collaborated on integrated delivery models, and developed strategies to improve performance, and shared resources to provide adult education across the state. However, Texas must become more efficient to ensure the greatest effectiveness in serving state priorities and needs. A strategic plan that addresses these new challenges, establishes a common vision with state level partners, and leverages state and regional partnerships would enable the Texas adult education system to advance Texas' education, economic, and workforce development goals and maximize its investment in adult education.

Recommendation 1 would include a rider in the introduced 2014–15 General Appropriations Bill to require TEA, in consultation with the Texas Workforce Investment Council, to revise and implement a statewide comprehensive strategic plan, goals, and objectives to address gaps in the adult education and literacy system, target specific state program goals and strategies, improve efficiency of coordinated activities between state agencies, increase education and work-related outcomes, and help to prepare adult students for employment. The plan would focus resources on achieving these goals and objectives over a five-year period. TEA would plan for ongoing monitoring and evaluation processes that measure progress, changes in the NRS data reporting procedures, and the potential reauthorization of the federal Workforce Investment Act. The plan would be submitted by TEA to the Legislative Budget Board and the Office of the Governor no later than December 1, 2014.

FISCAL IMPACT OF THE RECOMMENDATION

Recommendation 1 would have no significant fiscal impact for the 2014–15 biennium.

The introduced 2014–15 General Appropriations Bill includes a rider to implement this recommendation.

OVERVIEW OF ONLINE DISTANCE EDUCATION AT TEXAS COMMUNITY COLLEGE DISTRICTS

The use of distance education, particularly online learning, has increased in recent years. The Texas Higher Education Coordinating Board defines a distance education course as a course in which the majority of the instruction occurs when the students and the instructor are not in the same physical setting. In fall 2011, more than 528,000 students were enrolled in distance education programs at Texas public community colleges, and approximately 240,000 students were enrolled at Texas public universities. Although more students are enrolled in distance education at community colleges, universities are experiencing a higher enrollment growth rate. From fall 2006 to fall 2011, enrollment in distance education courses increased 87 percent at Texas public universities and 58 percent at community colleges.

According to national research, growth of online distance education programs is attributable to institutional efforts to expand access to more students, alleviate constraints on campus capacity, capitalize on emerging market opportunities, and compete with other schools. In July 2012, Legislative Budget Board staff surveyed all 50 Texas public community college districts about their experiences implementing, delivering, and expanding online distance education programs. The survey included questions regarding tuition and fees charged for online distance education courses; third-party contracts; and various program experiences. Staff compared the survey results to university survey data from a 2011 State Auditor's Office report on distance education at Texas' general academic institutions. The report findings are based on the 40 community college districts that provided complete survey information, representing a response rate of 80 percent.

FACTS AND FINDINGS

- ♦ Community college districts have more experience offering online distance education than universities. Of the 40 districts responding to the 2012 Legislative Budget Board survey, 35 (88 percent) have offered distance education options for more than 10 years compared to 25 universities (68 percent) responding to the 2011 State Auditor's Office survey.
- ♦ As enrollment increases, completion rates in online distance education courses are often used as a measure of quality and accountability. In fiscal year 2010, the statewide completion rate for students enrolled in online distance education at community college districts was 5 percent lower than the completion rates for students enrolled in similar classroom-based courses. For universities, the difference was 1 percent.
- ♦ Faculty training and support is a critical component of quality online distance education courses. Of the community college districts responding to the 2012 Legislative Budget Board survey, 78 percent require faculty to take online distance education professional development.
- ♦ The differences between the development costs and available funding for new classroom-based courses and the modifications necessary for online courses can be significant. Of the community college districts responding to the 2012 Legislative Budget Board survey, 46 percent charge higher tuition and fees for online courses than similar classroom-based courses.
- ♦ The range of online distance education fee types, fee amounts, and student fee exemptions vary widely across community college districts and universities. Of the districts responding to the 2012 Legislative Budget Board survey, 72 percent reported a unique fee charged to online distance education students, such as distance education/Internet fees, online course support fees, and electronic distance education fees. Ten districts (26 percent) reported fee exemptions specifically for online distance education students compared to 24 universities that offer fee exemptions for those students.
- ♦ According to community college districts, staffing and reductions in the state budget have posed the biggest challenges to implementing and expanding online distance education programs. Of the community college districts responding to the 2012 Legislative Budget Board survey, 85 percent agree that more staff needed to be hired to provide technical assistance to students and faculty to use the learning management system and technology. Also, 79 percent of districts agree that state budget reductions impaired their ability to implement and expand online distance education programs.

- ♦ Districts and universities may have more capacity for students to enroll in online distance education courses than the numbers of enrollees according to 36 percent of Legislative Budget Board survey respondents and 58 percent of State Auditor's Office survey respondents. Approximately 60 percent of universities and 44 percent of districts agree that effective marketing of online distance education programs to current and prospective students is not difficult.

DISCUSSION

Distance education began long before the advent of the Internet as correspondence courses, or home study courses that students completed by mail. Distance education now uses emerging technologies such as the Internet or audio conferencing to enhance the traditional method of educating. According to a 2011 U.S. Government Accountability Office (GAO) report, federal law defines distance education as:

> "...an education that uses one or more technologies to deliver instruction to students who are separated from the instructor and to support regular and substantive interaction between the students and instructor. Instruction provided through the Internet, or online, may be synchronous (simultaneous or real time) or asynchronous, whereby students and the instructor need not be present and available at the same time."

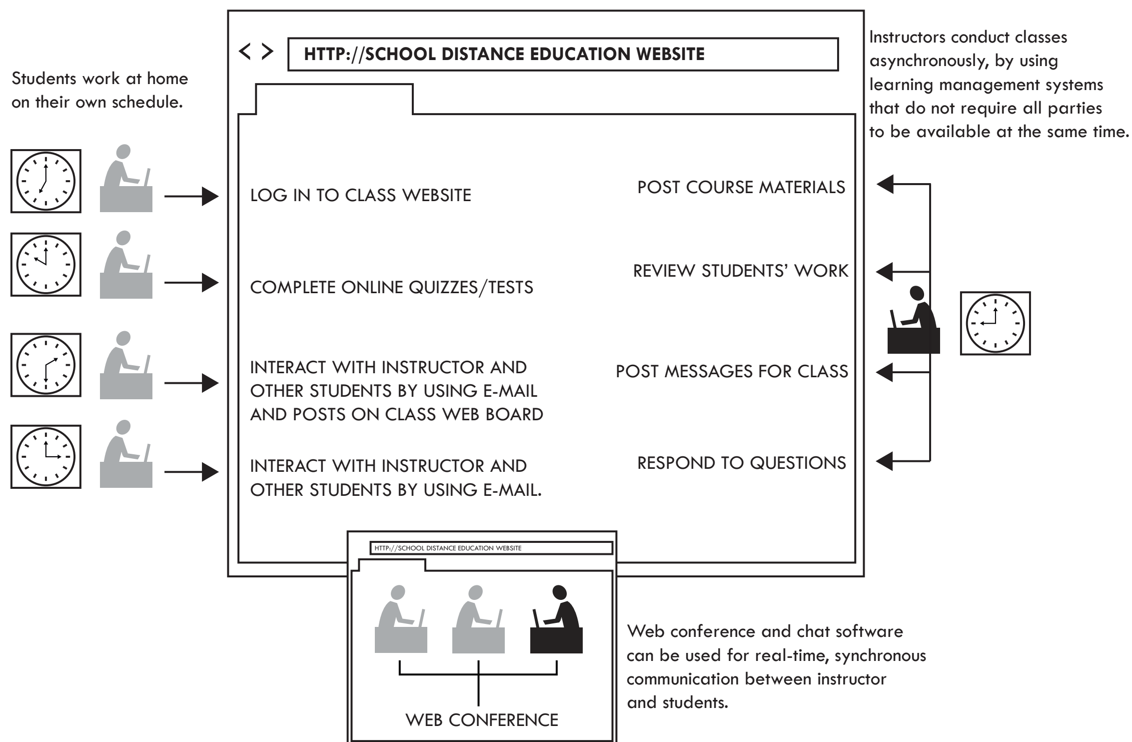
Figure 1 shows today's methods for offering distance education.

The Texas Higher Education Coordinating Board (THECB) rules define distance education as:

> "…the formal educational process that occurs when the students and the instructor are not in the same physical setting for the majority (more than 50 percent) of instruction. Distance education can include courses and programs offered online, off-campus face-to-face, and electronic to groups. A fully distance education course may have mandatory face-to face sessions totaling no more than 15 percent of instructional time."

According to the Texas Administrative Code, Rule 4.260, all institutions offering online and other electronically based courses shall adhere to the Principles of Good Practice for Electronically Offered Degree and Certificate Programs

FIGURE 1
ONLINE DISTANCE EDUCATION SYNCHRONOUS AND ASYNCHRONOUS LEARNING METHODS, 2011



SOURCE: U.S. Government Accountability Office.

developed by the Western Cooperative for Educational Telecommunications, a program of the Western Interstate Commission for Higher Education. To ensure new online courses comply with these principles, THECB developed a guide and evaluation process for institutions to follow. Institutions seeking approval for distance education plans through THECB must demonstrate that all courses adhere to the principles.

In July 2012, the Legislative Budget Board (LBB) staff surveyed all 50 Texas public community college districts about their experiences implementing, delivering, and expanding online distance education programs. The intent of the survey was to provide an overview of online distance education in Texas. It included questions regarding tuition and fees charged for online distance education courses; third-party contracts; and various program experiences for comparison to university survey data in the 2011 State Auditor's Office (SAO) report, *The Higher Education Coordinating Board Oversight of Distance Education at Texas' General Academic Institutions of Higher Education*. The findings in this report are based on the 40 community college districts that provided complete survey information, representing a response rate of 80 percent.

ONLINE DISTANCE EDUCATION-RELATED OPERATIONS AND MANAGEMENT

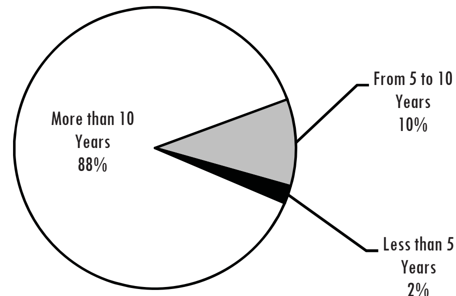
According to the LBB survey, community college districts have offered more online distance education options to students than Texas public universities for the past 10 years. Of the survey respondents, 35 districts (88 percent) indicated that they have offered online distance education options for more than 10 years as shown in **Figure 2**. The survey also indicated that 4 districts (10 percent) have offered online distance education options from 5 to 10 years. One district has offered online distance education options for less than 5 years.

In contrast, 25 of the 37 institutions (68 percent) included in the 2011 SAO survey of Texas public universities have offered distance education options for more than 10 years as shown in **Figure 3**.

ONLINE DISTANCE EDUCATION GROWTH

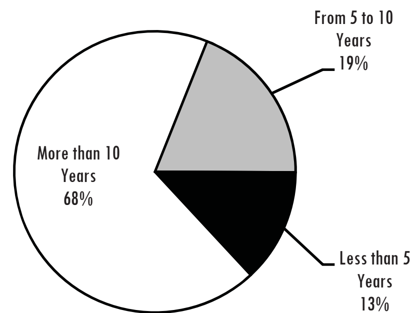
The use of distance education, particularly for online learning has grown in recent years. A 2011 Sloan Consortium study reported a 10 percent increase in online distance education enrollments from fall 2010 to fall 2011. The study also found that approximately 31 percent of higher education students were taking at least one online course.

FIGURE 2
TEXAS COMMUNITY COLLEGE DISTRICTS' EXPERIENCE WITH ONLINE DISTANCE EDUCATION, FISCAL YEAR 2012



Source: Legislative Budget Board.

FIGURE 3
TEXAS PUBLIC UNIVERSITIES' EXPERIENCE WITH ONLINE DISTANCE EDUCATION, FISCAL YEAR 2011



Source: State Auditor's Office.

For some institutions, online enrollments have been a source of total enrollment increases for the past five years. In fall 2011, more than 528,000 students were enrolled in distance education programs at Texas public community colleges, and approximately 240,000 students were enrolled at Texas public universities. These enrollments represented approximately 26 percent and 11 percent of total enrollments at those institutions respectively. Although more students are enrolled in distance education at community colleges, universities had a larger enrollment growth rate. From fall 2006 to fall 2011, enrollment in distance education courses

increased 87 percent at Texas public universities and 58 percent at community colleges.

According to THECB, from fall 2007 to fall 2011, total semester credit hours (SCHs) for online distance education increased from 9 percent to 14 percent of total SCHs for all programs reported by community colleges. THECB provided data on total online SCHs at universities and community colleges statewide for fiscal years 2010 and 2011 (**Figure 4**).

FIGURE 4
TOTAL ONLINE DISTANCE EDUCATION SEMESTER CREDIT HOURS FOR TEXAS TWO-YEAR INSTITUTIONS AND UNIVERSITIES, FISCAL YEARS 2010 AND 2011

INSTITUTION TYPE	2010	2011	PERCENTAGE CHANGE
Community Colleges	2,069,697	2,446,270	18%
Public Universities	1,088,185	1,341,321	23%

SOURCE: Texas Higher Education Coordinating Board.

ONLINE DISTANCE EDUCATION COMPLETION RATES COMPARED TO CLASSROOM-BASED COURSE COMPLETION RATES

As enrollment increases, completion rates in online distance education courses are often used as a measure of quality and accountability. To determine the completion rates of classroom-based students, and those students enrolled in online distance education, LBB staff compared the enrollment data for fiscal year 2010 in the THECB's Class Reports to the data in the End of Semester Reports. Based on this analysis, the statewide completion rate for students enrolled in online distance education was 83 percent or 5 percent lower than the 88 percent completion rate for students enrolled in classroom-based courses. **Figure 5** shows the completion rates for all courses offered at the 50 community college districts surveyed.

A 2011 Community College Research Center study of Washington State Community and Technical Colleges found that student completion rates for online courses were generally lower than for classroom-based courses. In Texas, there is considerable variation in these rates across community college districts. As **Figure 5** shows, 42 districts reported completion rates for online courses higher than 80 percent. Of those districts, Clarendon and Coastal Bend Colleges reported completion rates of 91 percent and 90 percent. Some institutions report retention in online courses consistent with retention in their classroom-based offerings, while others report non-completion rates as high as 27 percent. Data on course completions and retention is not always comparable among institutions or within an institution. Institutions use different methodologies to measure course completion in order to compare classroom-based courses to online courses. This practice can cause internal inconsistencies in the retention data.

According to the SAO survey, statewide completion rates for classroom-based courses and online courses at universities were higher than statewide completion rates at districts. During fiscal year 2010, statewide completion rates for classroom-based courses and online courses at universities were 95 percent and 94 percent respectively. Based on this analysis, the statewide completion rate for student enrolled in online distance education was 1 percent lower than the completion rates for students enrolled in classroom-based courses. This difference is also lower than the rate reported by districts in **Figure 5**.

POLICIES AND PROCEDURES

For the purposes of the Southern Association of Colleges and Schools (SACS) accreditation review, institutions must ensure that their distance education courses and programs comply with the Principles of Accreditation. SACS guidelines recommend that distance education policies are clear concerning ownership of materials, faculty compensation, copyright issues, and the use of revenue derived from the creation and production of software, telecourses, or other media products. Most institutions in the U.S. have established policies to address intellectual property rights for online distance education faculty and instructional web designers according to a 2011 national survey by the Instructional Technology Council.

In Texas, several community college districts and public universities lack formal policies and procedures for online distance education. According to the LBB survey, 29 districts (72 percent) reported having policies and procedures specific to online distance education. In contrast, the SAO found that 12 universities (32 percent) had policies and procedures that specifically address distance education. Because SAO completed its survey in 2011, it is possible that more institutions now have distance education policies. For districts, some of the common distance education policies were related to the following issues:

- explaining the purpose/mission of distance education;
- protecting intellectual property;

FIGURE 5
STUDENT COMPLETION RATES AT COMMUNITY COLLEGE DISTRICTS FOR CLASSROOM-BASED COURSES VERSUS ONLINE COURSES, FALL 2010

INSTITUTION	CLASSROOM-BASED COURSES	ONLINE COURSES	DIFFERENCE
Alamo Community College District	88%	83%	4%
Alvin Community College	89%	*	N/A
Amarillo College	87%	87%	0%
Angelina College	90%	89%	1%
Austin Community College	83%	88%	(5%)
Blinn College	87%	54%	33%
Brazosport College	90%	83%	7%
Central Texas College	89%	83%	6%
Cisco College	86%	83%	3%
Clarendon College	92%	91%	1%
Coastal Bend College	93%	90%	3%
College of The Mainland Community College	86%	*	N/A
Collin County Community College District	93%	88%	5%
Dallas County Community College District	88%	81%	7%
Del Mar College	86%	83%	3%
El Paso Community College District	90%	85%	5%
Frank Phillips College	86%	84%	2%
Galveston College	88%	*	N/A
Grayson County College	90%	88%	2%
Hill College	92%	89%	3%
Houston Community College	89%	85%	4%
Howard County Junior College District	92%	87%	5%
Kilgore College	85%	78%	7%
Laredo Community College	85%	78%	7%
Lee College	89%	82%	7%
Lone Star College System District	88%	84%	4%
McLennan Community College	83%	73%	10%
Midland College	91%	88%	3%
Navarro College	90%	84%	6%
North Central Texas College	86%	81%	5%
Northeast Texas Community College	91%	85%	6%
Odessa College	90%	86%	4%
Panola College	91%	86%	5%
Paris Junior College	92%	85%	7%
Ranger College	90%	88%	2%
San Jacinto Community College	89%	84%	4%
South Plains College	87%	83%	4%
South Texas College	90%	87%	3%

FIGURE 5 (CONTINUED)
STUDENT COMPLETION RATES AT COMMUNITY COLLEGE DISTRICTS FOR CLASSROOM-BASED COURSES VERSUS ONLINE COURSES, FALL 2010

INSTITUTION	CLASSROOM-BASED COURSES	ONLINE COURSES	DIFFERENCE
Southwest Texas Junior College	89%	84%	5%
Tarrant County College District	86%	82%	4%
Temple College	88%	80%	8%
Texarkana College	89%	81%	8%
Texas Southmost College	93%	88%	5%
Trinity Valley Community College	88%	75%	13%
Tyler Junior College	88%	84%	4%
Vernon College	93%	85%	8%
Victoria College, The	93%	89%	4%
Weatherford College	88%	84%	4%
Western Texas College	94%	89%	5%
Wharton County Junior College	89%	85%	3%
Statewide Summary	**88%**	**83%**	**5%**

*Three community college districts did not offer 100 percent online distance education courses in fiscal year 2010.
Source: Legislative Budget Board.

- information technology, including authorized users, software licensing, and user logins;
- allowable distance education expenditures;
- accessing and providing student services; and
- evaluating external course materials and instructors.

AVERAGE CLASS SIZE

Research suggests that faculty member activities when teaching an online distance education course are different than classroom-based activities. Rather than spending time in class prep and lecture, an online instructor's time is spent in the discussion boards and responding to e-mail. As a result, online course class sizes are often kept small. Among the surveyed community college districts, class sizes for online distance education courses ranged from 14 to 55 students per class. The average class size was approximately 24 students. Survey findings include:

- 50 percent of districts reported an average class size of less than 25 students—class sizes ranged from 14 to 24 in those districts;
- 17 percent of districts reported an average class size of 25 students; and
- 32 percent of districts reported an average class size greater than 25 students per class—class sizes ranged from 26 to as high as 55 among these 13 districts.

A 2010 Survey by the Campus Computing Project found that 73 percent of the institutions in their national survey limit the class size for online courses. Among those institutions, the enrollment cap averaged 35 students per class or section.

PROFESSIONAL DEVELOPMENT

Faculty training and support is a critical component of quality online distance education courses. To gain the knowledge necessary to implement online curriculum effectively, instructors need training, mentoring, and support; preferably on the equipment they will use. Faculty training must be considered when institutions plan for an online distance-education program. Some case studies of faculty development programs indicate that such programs can improve instructor transitions from a classroom setting to an online setting.

Of the LBB survey respondents, 31 (78 percent) require faculty to take professional development courses for online distance education. The LBB survey findings include:

- 9 districts (22 percent) do not require faculty to take distance education training programs.

- 12 districts (30 percent) require faculty to take eight hours or less training.
- 19 districts (47 percent) require faculty to take more than eight hours of training.

ONLINE DISTANCE EDUCATION FINANCIAL-RELATED INFORMATION

According to the 2009 *Florida Distance Learning Task Force Report*, the total cost of online distance education is a combination of costs for faculty, technology, content, and support services. The report indicated that factors affecting the total cost of online education include: student enrollment, course offerings, course development costs, course development cost sharing, technology choice, student support, content and teaching practices, staffing practices, and organizational structure. The variation of costs across institutions can be attributed to many factors, including organizational structure, technology choice, program volume, quality, and cost allocation methodology.

The differences between the development costs and available funding for new classroom-based courses and the modifications necessary for online courses can be significant. Community college districts could recover extraordinary costs for the development, delivery and support of these courses through student tuition and fees. The LBB survey findings include:

- none of the districts reported that their tuition and fees for online distance education courses were lower than the similar classroom-based courses;
- 21 districts (44 percent) charge equal tuition and fees for both online distance education courses and similar classroom-based courses; and
- 18 districts (46 percent) charge higher tuition and fees for online distance education courses than similar classroom-based courses.

Based on survey responses, one potential explanation for higher tuition and fees are the costs associated with managing, maintaining, and upgrading the general operations of a district's learning management system, used for content management and distribution, and other related online services.

DISTANCE EDUCATION FEES

The range of online distance education fee types, fee amounts, and student fee exemptions vary widely across community college districts and public universities. According to the LBB survey, 72 percent of districts reported charging a unique fee to online distance education students. Fees include distance education/Internet fees, online instruction fees, distance learning fees, online course support fees, and electronic distance education fees. Fee amounts ranged from $12 to $55 per SCH, $25 to $50 per course enrolled, and $25 to $40 per hybrid/online course. The remaining 28 percent of districts responding do not charge a unique fee.

Of the LBB survey respondents, 10 districts (26 percent) report offering fee exemptions specifically for online distance education students. The Texas Education Code, Section 54.218, authorizes governing boards of public institutions of higher education to waive a fee if the board determines that:

- a student is enrolled only in distance learning courses or other off-campus courses of the institution;
- the student cannot be reasonably expected to use the activities, services, or facilities on which the fee is based; and
- the waiver of the fee will not materially impair the ability of the institution either to service any debt on which the fee is based or to offer or operate the particular activity, service, or facility supported by the fee.

Figure 6 shows the types of district fee exemptions for online distance education students reported in the LBB survey.

Of the districts surveyed, only a small number of student fee exemptions were provided by each district. Three districts

FIGURE 6
COMMUNITY COLLEGE DISTRICT FEE EXEMPTIONS FOR ONLINE DISTANCE EDUCATION STUDENTS, FISCAL YEAR 2012

TYPE OF FEE	NUMBER OF DISTRICTS WITH FEE EXEMPTIONS
Facilities Use/Infrastructure	2
Distance Education/Internet	3
Vehicle Registration	1
International Education	1
Medical/Health Services	2
Student Union	1
Student Recreation	1
Parking	2
Campus Safety	1
Student Life	1

SOURCE: Legislative Budget Board.

provide distance education/Internet fee exemptions for students enrolled in dual enrollment, hybrid and video conference, and online distance education courses. Two districts provide exemptions for facilities use/infrastructure fees, medical/health services fees, and parking fees.

In contrast, the SAO survey found 32 of the 37 universities surveyed assess specific fees for online distance education courses. The most common type of fee was the general online distance education fee, which was charged per SCH for each distance education course. This general distance education fee ranged from $12 per SCH to $240 per SCH, depending on the institution. Of the 37 institutions surveyed, 24 also stated that they exempted students enrolled in distance education courses from certain fees that students in classroom-based courses were required to pay.

THIRD-PARTY CONTRACTS FOR DISTANCE EDUCATION-RELATED SERVICES

Public institutions of higher education may enter into contracts with vendors for online distance education-related services. Both the LBB and SAO surveys requested a list of contracts that were in place during fiscal years 2010 and 2011 from districts and universities. Twenty districts (50 percent) provided a list of institution third-party contracts for online distance education. The districts reported approximately $8.6 million in contract expenditures, with contract periods that ranged from fall 2008 through fall 2011. Four of the 20 districts did not provide contract amounts citing confidentiality clauses.

In contrast, 21 universities (57 percent) provided a list of the third-party contracts for distance education-related programs. The institutions reported approximately $10 million in contract expenditures, with contract periods that ranged from June 2002 to May 2016. Of these 21 institutions, 10 did not provide contract amounts also citing confidentiality clauses according to the SAO survey.

Figure 7 shows online distance education services and products provided by vendors at the districts and universities surveyed.

For both community college districts and public universities responding to the LBB and SAO surveys, Blackboard, Inc. was the vendor that had the highest number of third-party contracts cited by 48 institutions. Respondus, Inc., a Windows exam creation tool compatible with Blackboard and other learning management systems, had the second highest number of third-party contracts cited by 22 institutions. It is important to note that institutions may not have reported all distance education-related contracts and amounts in the surveys.

FIGURE 7
ONLINE DISTANCE EDUCATION SERVICES AND PRODUCTS PROVIDED BY VENDORS AT COMMUNITY COLLEGE DISTRICTS AND UNIVERSITIES, FISCAL YEARS 2002 TO 2016

CONTRACTED VENDOR SERVICES AT COMMUNITY COLLEGE DISTRICTS	CONTRACTED VENDOR SERVICES AT UNIVERSITIES
Centralized learning management systems for faculty, students, and staff	Centralized learning management systems for faculty, students, and staff
Systems for online exams	Systems for online exams
Software to host Webinars or Web-based conferences	Software to host Webinars or Web-based conferences
Online tutoring software	Online tutoring software
Lecture capturing and archiving software	Lecture capturing and archiving software
Anti- plagiarism software	Anti-plagiarism software
Technical call center services	
Software to create learning activities on an Intranet	
Student assessment software	
Server security	
Learning Object Repository	
Early Alert and Case Management	
Monitoring System for Servers	

Sources: Legislative Budget Board; State Auditor's Office.

CHALLENGES AND BARRIERS TO USING AND EXPANDING ONLINE DISTANCE EDUCATION

In July 1996, THECB developed a Distance Learning Master Plan as required by statute. The plan provides guidance to institutions for the development of online distance education offerings including support services for students, information technology resources, and intellectual property rights. To identify areas that may pose challenges or barriers for institutions implementing or expanding their distance education programs, the LBB and SAO surveys asked questions about topics from the master plan.

Based on LBB survey responses, staffing and reductions in the state budget have posed the biggest challenges to developing and expanding online distance education programs. As shown in **Figure 8**, 85 percent of 39 districts surveyed indicated that more staff needed to be hired to provide technical assistance for students and faculty. Seventy-nine percent of 39 districts surveyed indicated that state budget reductions have impaired their ability to implement and expand online distance education programs.

A comparison of similar LBB and SAO survey questions and responses regarding potential challenges and barriers when implementing on-line distance education is shown in **Figure 8** and **Figure 9**. Survey results indicate that both districts and universities may have more capacity for students to enroll in online distance education courses. Specifically, 36 percent of the 39 LBB survey respondents and 58 percent of the 36 SAO survey respondents indicated having excess online enrollment capacity.

Although institutions reported a lack of student demand for certain online courses, significant percentages of community college districts and public universities indicated that effective marketing of online distance education programs to current and prospective students is not difficult. Approximately 60 percent of universities cited this response, compared with 44 percent of districts**.**

Another potential challenge for community college districts and public universities is obtaining course evaluations from online distance education students. According to research, student evaluation of teaching is considered a best practice

FIGURE 8
COMMUNITY COLLEGE DISTRICT CHALLENGES AND BARRIERS FOR ONLINE DISTANCE EDUCATION PROGRAMS, FISCAL YEAR 2012

SURVEY QUESTIONS	DISAGREE	NEUTRAL	AGREE	TOTAL NUMBER OF DISTRICT SURVEY RESPONDENTS
Recent state budget cuts have impaired the districts' ability to implement and/or expand online distance education programs.	13%	8%	79%	39
Additional staff needs to be hired to provide technical assistance to students and faculty to use the learning management system and technology.	8%	8%	85%	39
The district has more capacity for students to enroll in online distance education courses than it has enrollees.	33%	31%	36%	39
It is difficult to effectively market online distance education programs to current and prospective students.	44%	33%	23%	39
It is difficult to protect intellectual property and comply with copyright laws in an online distance education environment.	49%	36%	15%	39
It is difficult to deliver student orientation for students enrolled only in online education courses.	51%	23%	26%	39
Online distance education students are less likely to submit course evaluations that students enrolled in classroom-based courses.	31%	28%	41%	39
Recent state budget cuts have impaired the districts' ability to implement and/or expand online distance education programs.	13%	8%	79%	39
Additional staff needs to be hired to provide technical assistance to students and faculty to use the learning management system and technology.	8%	8%	85%	39
The district has more capacity for students to enroll in online distance education courses than it has enrollees.	33%	31%	36%	39

SOURCE: Legislative Budget Board.

FIGURE 9
UNIVERSITY CHALLENGES AND BARRIERS FOR ONLINE EDUCATION PROGRAMS, FISCAL YEAR 2011

CHALLENGE OR BARRIER	DISAGREE	NEUTRAL	AGREE	TOTAL SURVEY RESPONDENTS
The institution has more capacity for students to enroll in online distance education courses than it has enrollees.	17%	25%	58%	36
It is difficult to effectively market online distance education programs to current and prospective students.	60%	26%	14%	35
It is difficult to protect intellectual property and comply with copyright laws in an online distance education environment.	50%	36%	14%	36
It is difficult to deliver student orientation for students enrolled only in online education courses.	61%	28%	11%	36
Online distance education students are less likely to submit course evaluations that students enrolled in classroom-based courses.	53%	25%	22%	36

Source: State Auditor's Office.

for ensuring quality and the continued improvement and success of online distance education courses. Districts and universities differ in their course evaluation submission rates from students in online distance education courses. As shown in **Figure 8**, 41 percent of districts indicated that online distance education students are less likely to submit course evaluations than classroom-based students are. As shown in **Figure 9**, 53 percent of universities agreed with this statement.

PLANS FOR ONLINE DISTANCE EDUCATION

Both LBB and SAO surveys gave districts and universities the opportunity to provide additional comments regarding their experiences with online distance education, plans for distance education programs, course assessment, and continuous program improvement. Common themes for reported included plans for improving program assessment, course quality, and expanding programs.

Thirty-one districts provided comments related to their online distance education programs. Fifteen districts reported how online courses and programs are assessed through committees, faculty, and student evaluations to improve quality. Several districts mentioned plans to expand course offerings to meet student demand. One district reported plans to expand use of open educational resources, professional development, increase hybrid course offerings, develop a strategic plan, and expand online tutoring services.

According to the SAO survey, 17 of the 37 universities surveyed provided comments related to their distance education programs. Five institutions indicated that they plan to expand their online distance education programs to offer more course variety. Other institutions stated they were working to identify partnerships and collaborations to maximize programs, improving internal peer assessment processes, and considering peer review to improve course quality.

IMPROVE ONLINE DISTANCE EDUCATION AT COMMUNITY COLLEGES BY USING COOPERATIVE CONTRACTS AND OPEN EDUCATION RESOURCES

The state's higher education master plan, *Closing the Gaps by 2015*, calls for an increase of 5.7 percent, or 630,000 students, participating in higher education and 112,500 students obtaining baccalaureate degrees from 2000 to 2015. For the past decade, the Texas Higher Education Coordinating Board has identified online distance education as a long-term, cost-effective means of providing educational access to achieve those state goals. In September 2009, the Governor directed the Texas Higher Education Coordinating Board to work with public institutions of higher education to identify opportunities for greater cost efficiencies in higher education. In response, institutions increased their efforts to develop online and blended courses and implemented online course management systems.

In fiscal year 2011, 47 Texas community college districts reported offering fully online distance education courses. In July 2012, the Legislative Budget Board staff surveyed the 50 community college districts. Survey respondents identified barriers to expanding the number of distance education offerings including: ensuring quality of online instruction, limited fiscal resources, and course development costs. Cost saving tools such as cooperative purchasing agreements and open education resources are in limited use by districts. Given the expansion of online distance learning activities and the use of technology products and services, community college districts could reduce costs by increased participation in statewide cooperative contract purchasing and expanding the use of open education resources.

FACTS AND FINDINGS

- ♦ The Virtual College of Texas has developed several statewide contracts for web-based software to support community colleges development of on-line education courses. These contracts provide colleges with access to tools that facilitate peer review of online courses and that assess a learner's readiness to succeed in an online learning program.
- ♦ Texas community college districts surveyed in July 2012 reported expenditures of $8.5 million on vendor contracts for online distance education products and services.
- ♦ Forty-six percent of Texas community college districts surveyed in July 2012 reported charging students higher tuition and fees for online distance education courses than similar traditional face-to-face courses.
- ♦ National research shows that open educational resources can save institutions significant costs in their online distance education programs. These resources have been released under an intellectual property license that permits their free use or re-purposing by others. A 2011 study of the Open Course Library in Washington State estimated savings of $1.2 million during the 2011–12 school year.

CONCERNS

- ♦ The state has not developed a statewide contract for public institutions of higher education to purchase online distance education products and services used by many districts. Students may be charged higher tuition and fees to cover those costs. A consolidated state contract would allow Texas to negotiate discounts based on the combined user volume and would help to reduce the cost of offering distance education.
- ♦ Sixty-two percent of districts surveyed reported they did not use open educational resources and were not sure how to implement them. The state has not facilitated the sharing of open educational resources among public institutions of higher education. This contributes to institutions not using open educational resources and increases the cost to develop and offer online education.

RECOMMENDATIONS

- ♦ **Recommendation 1:** Include a rider in the introduced 2014–15 General Appropriation Bill to direct the Department of Information Resources, in consultation with the Texas Higher Education Coordinating Board, to consider if the state would benefit from preferred pricing and collaborative statewide contracts for recommended online distance education-related products and services routinely purchased by Texas' universities and community college districts. For products and services found to

have a state benefit, the Department of Information Resources may use existing group purchasing programs to develop statewide contracts for Texas' universities and community college districts.

- ♦ **Recommendation 2:** Include a rider in the introduced 2014–15 General Appropriation Bill to direct the Texas Higher Education Coordinating Board, in consultation with the Virtual College of Texas, to study and recommend policies regarding the availability and use of open educational resources in Texas.

DISCUSSION

The state's higher education master plan, *Closing the Gaps by 2015*, includes goals to increase the number of students participating in public higher education by 5.7 percent, or 630,000 students, and for 112,500 students to obtain baccalaureate degrees from 2000 to 2015. For the past decade, the Texas Higher Education Coordinating Board (THECB) has identified online distance education as a long-term, cost-effective means of providing educational access to achieve those state goals In September 2009, the Governor directed THECB to work with public institutions of higher education to identify opportunities for greater cost efficiencies in higher education. In response, institutions increased their efforts to develop online and blended courses and implemented online course management systems such as Blackboard. Institutions report that expanding distance education offerings required significant start-up costs including investments in technology, instructional design, web design, and training for instructors in the art of online instruction.

Nevertheless, 47 Texas community college districts offer online distance education. THECB defines distance education as a course in which the majority of the instruction occurs when the students and the instructor are not in the same physical setting. A distance education course can be delivered to single or multiple locations through audio, video, Internet, correspondence, or telecommunications. The course may be formula-funded or offered as an extension course, and it may be delivered to on-campus students and those who do not take courses on the main campus.

As shown in **Figure 1**, districts offered 1.8 million semester credit hours (SCH) through online distance education during fall and spring semesters in fiscal year 2012, an increase of 23 percent from fiscal year 2010. Several districts also reported online distance education program enrollment up to 30 percent of total enrollment at their institution.

FIGURE 1
COMMUNITY COLLEGE DISTRICT SEMESTER CREDIT HOURS REPORTED
FALL AND SPRING SEMESTERS
FISCAL YEARS 2010 TO 2012

FISCAL YEAR	TOTAL FALL AND SPRING SEMESTER CREDIT HOURS REPORTED IN ONLINE EDUCATION COURSES	PERCENTAGE CHANGE FROM FISCAL YEAR 2010
2010	1,490,202	0%
2011	1,727,885	16%
2012	1,838,327	23%

SOURCE: Texas Higher Education Coordinating Board.

In July 2012, LBB staff surveyed all 50 Texas public community college districts about their experiences implementing, delivering, and expanding online distance education programs. Forty districts, or 80 percent of all districts, responded to the survey. Even though student demand appears to be increasing, survey results indicate that ensuring the consistency of quality in online instruction, limited resources, and start up costs including technology such as computer hardware, software, and support are often barriers to expanding these programs. Tools such as statewide purchasing agreements and open education resources to reduce those costs were limited in use by districts statewide.

STATEWIDE PURCHASING AGREEMENTS

Institutions often enter into contracts with vendors for online distance education-related services. The 2012 LBB staff survey requested a list of distance education-related contracts that were in place during fiscal years 2010 and 2011. Twenty-two districts surveyed provided a list of the third-party contract agreements between the institution and a vendor for distance education-related programs. The institutions surveyed reported contracts totaling $8.5 million in expenditures related to online distance education. Services and products provided by those vendors included:

- centralized learning management systems for faculty, students, and staff;
- systems for online exams;
- software to host webinars or web-based conferences;
- online tutoring software;
- lecture capturing and archiving software; and

- anti-plagiarism software.

Blackboard, Inc. was the vendor with the most distance education-related contracts according to survey results. Twenty-four districts, or 60 percent, of districts surveyed reported using Blackboard or WebCT learning management systems for online education programs. All institutions surveyed reported using learning management systems for content management and distribution.

The 2002 THECB report, *Critical Issues Facing Distance Education in Texas*, recognized that statewide purchasing agreements and volume-based negotiations are useful strategies for managing costs. In the report, course management tools such as Blackboard or WebCT also ranked as the most critical category for statewide purchasing consideration.

Statewide purchasing agreements and volume-based negotiations help entities establish favorable contracts for products and services. The Department of Information Resources (DIR) cooperative contracts program leverages the state's volume-buying power to reduce costs on technology contracts. State agencies, local governments, institutions of higher education, and some non-profits and out-of-state public entities are eligible to use these contracts. In fiscal year 2011, the program had more than $1.5 billion in sales generating more than $270 million in savings.

According to DIR, the program uses customer input and sourcing analytics to determine the need for IT products and services and then releases requests for offers (RFOs) when sufficient customer demand exists. Multiple contracts are awarded to vendors with established discounts for a quantity of purchases but purchases are not guaranteed. Once the contracts are established, eligible customers buy directly from the contracted vendors.

Customers may negotiate additional discounts, such as for large volume purchases; develop customized statements of work, including performance and service level agreements; or even issue their own RFOs among contracted vendors. The program is designed to allow eligible customers the flexibility to buy from the base contract as-is or tailor contracts to their specific needs, budgets, and projects.

In fiscal years 2011 and 2012, community college districts individually purchased more than $125 million in products and services using DIR's cooperative contracts. DIR staff reported that community colleges saved approximately $11 million on individual purchases through the program in fiscal year 2011. However, as of August 2012 districts had not purchased course management software or learning management systems such as Blackboard, or WebCT through the program.

VIRTUAL COLLEGE OF TEXAS

The Virtual College of Texas (VCT) is a collaborative of Texas community and technical colleges that works to increase access to higher education and improve student success by sharing of online education resources among Texas two-year colleges. In fiscal year 2009, VCT negotiated and purchased discounted licenses to web-based services. These licenses include a program for assessing student readiness for distance learning, an instructor-friendly online lesson builder that offers exceptional multi-purpose lesson-building power, and a repository of video and animation learning objects. VCT also received a web-based system from the TeleCampus, part of The University of Texas System that facilitates instructor peer review of online courses.

Governance of the VCT rests with the Texas Association of Community Colleges (TACC). A small staff that operates with the guidance and counsel of a TACC-appointed committee administers VCT. This committee has representation from the six TACC-defined regions of Texas, instructional and technical areas, and institutions of varying size. VCT staff implement policies established by TACC and its committees. VCT is funded through the Austin Community College Strategy, in the General Appropriations Act. During the 2012–13 biennium, VCT received more than $700,000 in General Revenue Funds.

The 2012 LBB staff survey found that VCT has saved community college districts money by negotiating statewide agreements for web-based software such as programs that facilitate online peer review of online courses and web-based tools that assess a learner's readiness to succeed in an online learning program. Thirty-seven districts, or 90 percent, responding to the survey reported using three software packages purchased by VCT that were provided free to all districts statewide.

Although VCT has obtained favorable pricing arrangements for a limited range of online distance learning software products and services, the lack of clear authority to negotiate preferred pricing and execute statewide agreements for all community college districts can be cumbersome and confusing to vendors. In 2011, the Florida Distance Education Task Force identified that businesses seeking to offer large-scale pricing agreements for community colleges and state universities found it difficult to approach Florida's

educational community due to its varied educational governance structure. As a result, the Task Force recommended clear authority be given to the Florida Distance Education Consortium to pursue these arrangements.

TEXAS HIGHER EDUCATION COORDINATING BOARD OVERSIGHT

The Texas Education Code designates THECB as the central resource for distance education in the state. THECB's responsibilities include:

- the development of a Distance Learning Master Plan;
- receipt and review of institutional plans for distance education; and
- notification and approval of distance education courses and programs.

THECB also maintains distance education enrollment and SCH data, and some financial distance education financial data.

The THECB Learning Technology Advisory Committee includes representatives from public community and technical colleges, universities, and health-related institutions; students and THECB staff. The committee provides recommendations on various distance education issues and charges to THECB. The committee is currently working on tasks such as the use of learning technologies for high-quality undergraduate education and increase student success; the cost of distance education; the role of technology in instructional cost effectiveness; the development of institutional collaboratives; and ways to use technology to increase student retention and success.

As a central resource for online distance education, THECB is uniquely situated to be a catalyst for change. Clear authority for THECB to facilitate statewide purchasing agreements through DIR would allow Texas institutions of higher education to capitalize on savings opportunities that exist in these areas. Recommendation 1 would include a rider in the introduced 2014–15 General Appropriation Bill to direct DIR, in consultation with the THECB, to consider if the state would benefit from preferred pricing and collaborative statewide contracts for recommended online distance education-related products and services routinely purchased by Texas' universities and community college districts. For products and services found to have a state benefit, the DIR would use existing group purchasing programs to develop statewide contracts for Texas' universities and community college districts.

OPEN EDUCATION RESOURCES

Another tool that can reduce the cost of developing online education courses is open educational resources (OERs). OERs include teaching, learning, and research resources that reside in the public domain or have been released under an intellectual property license that permits their free use or re-purposing by others. OERs include courses, course materials, content modules, learning objects, collections, and journals. OERs also comprise tools for delivering educational content such as software that supports the development, delivery, use and improvement of open learning content, searching and organization of content, content and learning management systems, content development tools, and online learning communities. Resources for the implementation of OERs include intellectual property licenses that govern open publishing of materials, design-principles, and customization of content.

According to research, the use of OERs is increasing rapidly, but there are many obstacles to widespread acceptance. Use of OERs can raise concerns relating to intellectual property rights, costs, and quality assurance. Educators must evaluate supplemental materials for relevance and quality to alleviate these concerns.

In the 2012 LBB staff survey, 14 districts, or 36 percent, reported they are using OERs for online distance education courses. Seven districts, or 17 percent, reported using Moodle, an OERs learning management system. Conversely, 17 districts, or 44 percent, reported not using OERs, and being unsure about implementation. Institutions believe that OERs have the potential to reduce costs, but, according to a 2011 national survey, institutions report that finding and evaluating OERs products takes a considerable amount of faculty time. Institutions also support establishing a centralized repository of OERs products to increase their use.

DIGITAL REPOSITORIES

As more institutions in the state actively engage in the development of digital content, there is a growing need to share that content to increase efficiency, reduce duplication, and foster collaboration. According to the Florida Distance Learning Task Force, a repository is a storehouse for digital resources that range from documents to multimedia learning objects with animations and video clips. While repositories may hold many forms of digital content, they also include descriptive information or "meta tags" which allow easy identification, classification, and access through Internet search capabilities. Many repositories store materials

produced by a single educational or research institution including faculty and institutional research materials or instructional resources. Other stored digital repository content may be administrative reports, scholarly collections, digitized records, or exhibitions and performances. However, within the infrastructure made available, there is generally no limit to the types of digital content that repositories can archive.

In addition to the single institution model, shared multi-institution repositories also exist in which faculty and staff members at different institutions can "deposit and withdraw" content as defined by a cooperative agreement. Repositories can provide a free or reduced cost to access instructional resources and disseminate products produced by federal and state grants. Significant savings in the development costs for an individual lesson plan or course could be realized by using a statewide educational repository in which instructional resources are shared. A statewide repository also avoids isolated silos of content, which can occur when institutions develop internal systems that may not be standards based. A 2011 study of the Open Course Library in Washington State estimated a cost savings of $1.2 million during the 2011–12 school year.

Several states including Washington, California, Georgia, North Carolina, and Florida have implemented policies regarding OERs and established state repositories. Some of these repositories contain only courses, learning objects for course development, and online textbooks. Florida and North Carolina use a broader state repository approach with numerous resources available at a free or reduced cost.

ORANGE GROVE DIGITAL REPOSITORY

The Florida Distance Learning Consortium developed the Orange Grove Digital Repository in 2001. The repository houses instructional resources funded by the State of Florida, content from other standards-based repositories, content from websites across the U.S., and multimedia content licensed from the National Repository of Online Courses and Kentucky Educational TV. Because The Orange Grove Digital Repository can communicate with other collections and repositories, repository users can locate between 60,000 and 80,000 additional instructional resources from other state, national, and international repository sites. Florida's model demonstrates the ability to capture and share OER resources from a variety of sources.

NORTH CAROLINA LEARNING OBJECT REPOSITORY

The North Carolina Learning Object Repository (NCLOR) began production in January 2008, fully integrated with course management and data systems, and operational for North Carolina faculty to develop and use sharable content. The NCLOR collects documents, audio/video clips, simulations, learning modules, assessments, and virtually any type of learning resource that can be digitized and processed. Teachers statewide can then search the NCLOR, find materials appropriate to the classes they are teaching, and use them as is or modify them to suit their needs. This concept of sharing and reusing is the core of the NCLOR philosophy. Teachers can become more productive and efficient.

A centralized NCLOR was created in 2006 to be a repository of digital learning content that will be accessed and utilized by all pre-K–20 educational institutions in North Carolina, eliminating the duplicative costs of content development and allowing seamless integration with a Learning Management System (LMS).

Representatives from all NC educational sectors (community colleges, universities, and independent colleges and universities) participated in creation and development of NCLOR from inception to production. It was determined that the NCLOR would provide the following benefits:

- centralize hosting to reduce costs of hardware and IT;
- capability for instructors to share learning object (LO) items;
- capability for newly developed LO items to be moderated, improved, deployed, and shared;
- reduce duplication of effort and save development resources statewide;
- integrate easily with a LMS for ease of course creation
- the ability to set permissions for client populations;
- report and usage capabilities; and
- conform to standards governing content, protocol, and federation.

The NCLOR is managed by the North Carolina Community College System but is a collaborative effort with the University System of North Carolina, NC Department of Public Instruction, NC Virtual Public Schools, and independent colleges and universities.

TEXAS LEARNING OBJECT REPOSITORY

Texas has a learning object repository under development currently funded through state grants. The Texas Education Code, Section 61.0763, requires THECB to implement a project under which institutions of higher education selected by the board will review, revise entry-level lower division academic courses to improve student learning, and reduce the cost of course delivery through the use of information technology. The Texas Learning Object Repository (TxLOR) serves as the primary mechanism for the Texas course redesign project. The goal of the project was to spread the adoption of course designs that increase success in student learning, while simultaneously reducing delivery costs of courses.

The THECB approach to this effort is based on the ongoing work of the National Center for Academic Transformation (NCAT). The NCAT Program in Course Redesign focuses on large enrollment, introductory courses, which could accessed by a significant number of students and generate substantial cost savings. THECB has extended this model to facilitate progress towards the *Closing the Gaps* goals, which seek to increase the success of historically underrepresented groups in institutions of higher education in Texas. Accordingly, THECB is interested in courses that combine developmental and college-level courses. For example, THECB has approved courses for development that combine developmental writing with history and developmental writing with political science.

The University of North Texas completed a THECB pilot study in 2010 that found the development of a learning object repository to provide easy searching for objects was possible in Texas. The study found that metadata tagging systems could be developed that would allow end user ease of search and could be at least partially automated to facilitate tagging, and identified copyright issues involving digital materials. The study also found that out of state repositories could be cost prohibitive to some Texas institutions. As a result, the TxLOR Advisory Commission was established, general principles were identified, work groups were formed, metadata standards were determined, partnerships were developed, and the TxLOR site was launched.

The THECB and the University of Texas System Office of Health Affairs (UTSOHA) jointly fund the TxLOR . Both institutions were seeking to address specific issues for which the idea of a digital repository was an appropriate solution. THECB needed a means to easily disseminate the digital products from their course redesign grants across the state. UTSOHA was interested in reducing the amount of duplication in the development of digital learning resources, which was occurring across the six UT health-related institutions. Both THECB and UTSOHA have contributed equal amounts of funding over the four-year project schedule totaling approximately $900,000. The Texas Digital Library (TDL) is a contracted partner with the TxLOR to host and support the development of the system for course sharing.

Because digital instructional materials are expensive to develop, institutions and faculty can reduce costs by sharing resources with other educators outside of their institution and the state. Sharing the resources developed with state dollars leverages the state's investment and reduces duplication of effort. Shared access to Texas content through a repository would not only reduce the cost of course development, testing, and textbooks but also increase faculty productivity, course quality, and access to a variety of open educational resources that further enhances the instructional experiences of online distance learning and traditional courses.

Recommendation 2 would include a rider in the introduced 2014–15 General Appropriations Bill to direct THECB, in consultation with VCT, to study and recommend policies regarding the availability and use of open educational resources in Texas. The report should examine the use of TxLOR and provide recommendations for expanding it through federation or other mechanisms, identifying new potential users, and using best practices to ensure quality and sustainability. The report should include recommendations for the development of training and support for faculty at institutions of higher education in using these resources. The report should also include policy recommendations for the establishment of a state digital repository for all open educational resources developed with state funds, and methods for encouraging the use of open educational resources at public institutions of higher education.

FISCAL IMPACT OF THE RECOMMENDATIONS

These recommendations do not have a direct fiscal impact to the state.

Recommendation 1 is based on existing practices at DIR and could be implemented within existing resources. Recommendation 2 does not have a fiscal impact.

The introduced 2014–15 General Appropriations Bill includes riders to implement Recommendations 1 and 2.

LIMIT STATE FUNDING OF SCHOOL DISTRICT PARTICIPATION IN TAX INCREMENT REINVESTMENT ZONES

Tax increment reinvestment zones are quasi-governmental entities in the state of Texas established to implement tax increment financing. These zones rely on tax increment financing to fund infrastructure improvements in a designated area. Tax increment financing is a process in which the taxing entities supporting the zone's development deposit property tax revenue associated with increasing property value into a tax increment fund. The difference between the base-year property value when the zone is established and each year's higher property value is referred to as the captured appraised value. The tax increment is the product of the captured appraised value multiplied by each entities' tax rate, or an alternative formula that may include the tax rate multiplied by the captured appraised value. This increment funds the debt service and/or ongoing project costs associated with development of the zone.

Cities can establish and administer these zones, and establish agreements with public independent school districts and other taxing entities to jointly finance their development. Certain school districts benefit from an offset, authorized by state law, that deducts the captured appraised value from a district's total property value, and reduces maintenance and operations tax collections, such that districts receive more state funding or pay lower recapture amounts to the state. In fiscal year 2011, this offset benefitted 33 school districts at a cost of approximately $139.4 million in General Revenue Funds.

In addition to the property value and tax rate offset, certain school districts also receive a supplement from the state related to the tax rate reduction legislation of 2006. In fiscal year 2011, 19 school districts received the supplement, at a cost of approximately $32.5 million in General Revenue Funds.

The supplement is an open-ended cost to the state, which current state law does not adequately control. Amending state law to limit this cost would save the General Revenue Fund $64.0 million in the 2014–15 biennium. Also, given the complex nature of state statutes governing the effect of tax increment reinvestment zone participation on state funding for school districts, specific information should be provided to the districts so they can understand how their reinvestment zone agreements will impact their state support.

FACTS AND FINDINGS

- ♦ In Texas, 33 public independent school districts participate with other taxing entities in tax increment reinvestment zones.
- ♦ Taxing entities participating in a reinvestment zone are authorized to change the geographic boundaries (size) of the zone, as well as the term (duration) of the zone.
- ♦ Tax increment reinvestment zones in which school districts participate would not experience a financial hardship if the statutory requirement for school districts to contribute to tax increment reinvestment zones an additional amount based on the school districts' 2005 tax rate, and the related supplement provided by the Texas Education Agency to school districts, were both suspended during the 2014–15 biennium.

CONCERNS

- ♦ Certain school districts participate in tax increment reinvestment zones in which more than half of the school district's contribution is used to construct or renovate school district educational facilities. In these cases, a supplement based on 2005 tax rates is unnecessary because their tax increment contributions primarily benefit these school districts.
- ♦ The supplement provided to certain school districts associated with tax increment reinvestment zone participation represents a biennial General Revenue Fund cost which is unnecessary during the 2014–15 biennium in light of the current financial condition of these tax increment reinvestment zones.
- ♦ The Comptroller of Public Accounts does not adequately monitor changes in the size or duration of tax increment reinvestment zones that could result in an inaccurate determination of school district property values used to calculate state aid and recapture payments.
- ♦ A 2011 Legislative Budget Board staff survey found that some school districts are uncertain if changes to the zone boundaries or duration affect their

Foundation School Program funding. The state does not regularly notify school districts about state law governing the property value offset and supplemental funding related to tax increment reinvestment zones.

RECOMMENDATIONS

- **Recommendation 1**: Amend statute to eliminate the state supplement to public independent school districts participating in tax increment reinvestment zones for whom more than half of their tax increment contribution supports school district facility development, and suspend the supplement for all other eligible school districts during the 2014–15 biennium. To ensure school districts are not adversely affected and can contribute to a zone based on their current tax rates, the statutory provision requiring districts to contribute at the 2005 tax rate would be removed for those districts that would no longer receive the supplement. The requirement would also be suspended during the 2014–15 biennium for all other school districts participating in tax increment reinvestment zones that have received the supplement.
- **Recommendation 2**: Amend statute to prohibit school districts that have not received the supplement as of calendar year 2012 from applying for and receiving the funding in the future.
- **Recommendation 3**: Include a contingency rider in the 2014–15 General Appropriations Bill to require the Texas Education Agency to withhold the state funding for the tax increment reinvestment zone-related supplement from Foundation School Program appropriations for the 2014–15 biennium.
- **Recommendation 4**: Amend statute to require the Comptroller of Public Accounts to review local agreements, financing plans, and amendments to those documents, of the tax increment reinvestment zones in which school districts participate to identify the zone boundaries and durations that were in place before September 1, 1999, and take any other steps necessary to ensure that school districts are receiving only the amount of tax reinvestment zone property value deductions specified by state statutes.
- **Recommendation 5**: Amend statute to require the Comptroller of Public Accounts to inform all affected school districts of state law provisions related to the reinvestment zone agreement property value offset and supplemental funding. This information, provided at the beginning of each biennium, should emphasize if changes to the size or duration of a zone implemented by its governing body will affect those financial benefits.

DISCUSSION

Tax increment reinvestment zones (TIRZs) are quasi-governmental entities in the state of Texas established to implement tax increment financing. TIRZs use tax increment financing to pay for infrastructure improvements in a designated area. Tax increment financing is a mechanism through which taxing entities contribute property tax revenue associated with increasing property value into a tax increment fund. The captured appraised value is the difference between the base-year property value, when the zone is established, and each year's higher property value. Typically, the tax increment is determined by multiplying the captured appraised value multiplied by each entity's tax rate. However, taxing entities may agree to an alternative formula, such as contributing an amount based on some percentage of the tax rate. This increment pays for the debt service and/or ongoing project costs associated with developing the zone.

TIRZs often include a city and one or more taxing entities, such as a school district, in order to pool resources for the development of a zone. Certain public independent school districts (ISDs) participating in TIRZs benefit from statutory provisions that subtract their captured appraised value from their total property value, and reduce their maintenance and operations (M&O) tax collections. The districts can then receive more state funding or pay lower recapture amounts to the state, effectively holding district revenue harmless for participation in TIRZs. State law was amended in 1997 so that after fiscal year 1999, ISDs entering into TIRZ agreements would not receive either of these two adjustments. In fiscal year 2011, 33 ISDs benefitted from these adjustments, at a cost of approximately $139.4 million in General Revenue Funds.

Some ISDs, in addition to property value and tax collection adjustments, receive a supplement related to the tax-rate reduction legislation of 2006. To minimize the impact on TIRZ financing, the legislation required certain ISDs to continue basing their tax increment contribution on 2005 tax rates. This requirement does not apply to school districts for which their TIRZ contribution is based on a specific tax rate indicated in their TIRZ agreement. To hold ISDs harmless, the state provides a supplement based on the

difference between the 2005 tax rates and their current tax rate. In fiscal year 2011, 19 ISDs received a supplement, at a cost of approximately $32.5 million in General Revenue Funds.

HISTORY AND PURPOSE OF TIRZS

Local governments in California became the first entities to use tax increment financing when its legislature authorized this funding mechanism in 1952. TIRZs in Texas rely on this approach to pay for economic development within their zones. Tax increment financing is a mechanism used by local governments to finance needed improvements to infrastructure and buildings within a TIRZ. The cost of improvements to the reinvestment zone is repaid by the tax revenues of each taxing entity that levies taxes on the property.

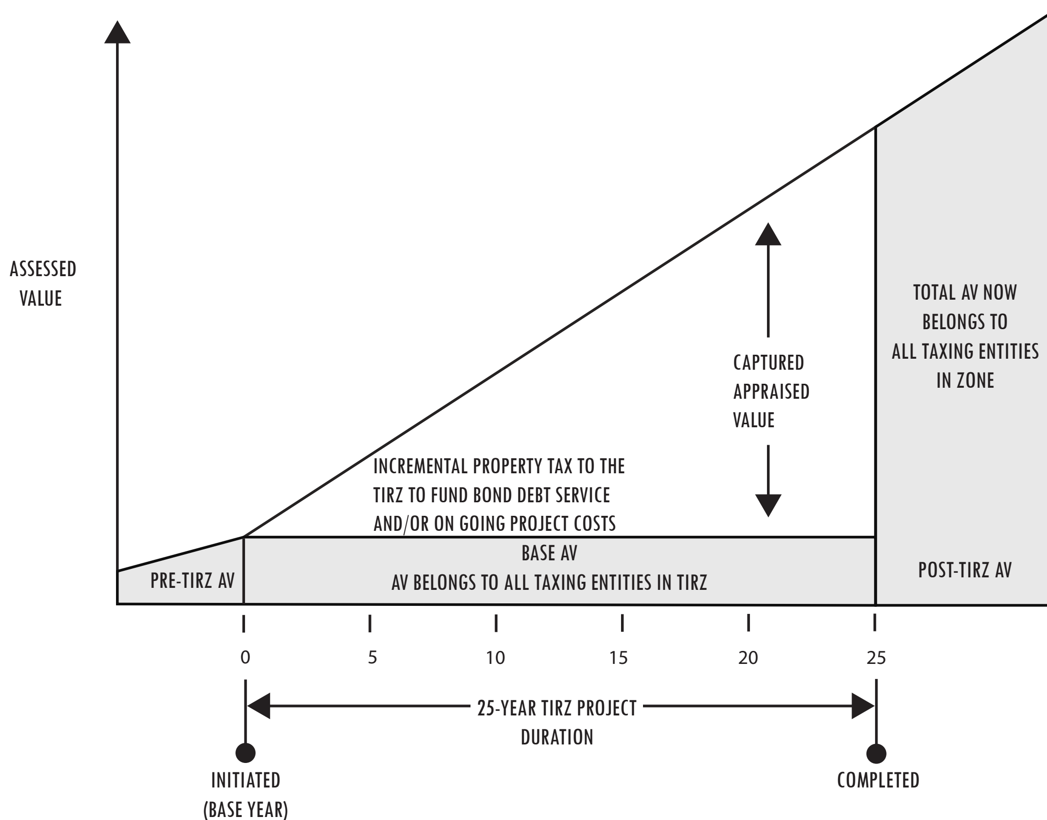
Figure 1 shows how tax increment financing is intended to work. When a city establishes a TIRZ, sometimes in conjunction with other taxing entities, a base tax year is determined by the participating taxing entities. Tax revenue generated from assessments on the base-year appraised value continues to flow to the taxing entities. To the extent property values rise, the additional tax revenue associated with the higher values, referred to as the captured appraised value, is deposited into a tax increment fund (TIF). In other words, the captured appraised value is each year's appraised value minus the base-year appraised value when the zone was established.

In this standard financing model, the captured appraised value, multiplied by each taxing entities tax rate, goes into the TIF to pay for the bond debt service and/or ongoing project costs that finance the development. This contribution is referred to as the tax increment. Upon expiration or termination of the TIRZ agreement, the participating taxing entities regain access to the entire appraised value.

ESTABLISHMENT AND ORGANIZATION OF A TIRZ

A TIRZ is a quasi-governmental entity administered by the city that establishes the zone. A board of directors representing

FIGURE 1
TAX INCREMENT FINANCING MODEL



Note: Tax Increment Reinvestment Zone (TIRZ) ; Appraised Value (AV).
Sources: Legislative Budget Board; Indiana University.

the taxing entities that are parties to the zone's agreement governs the zone, but the city that established the zone typically administers it. The Tax Increment Financing Act, of the Texas Tax Code, Chapter 311, sets forth specific procedures cities are required to follow to establish the TIRZ. Cities initially make a series of decisions related to the zone's territory, its mission and goals, development projects, financing, and governance. A key step is working with other taxing entities, including ISDs that may be interested in participating in the zone. ISDs participate in TIRZs to promote economic development, to increase property tax revenue, and finance the construction or modifications of educational facilities located within the zone.

Certain ISDs that participate in TIRZs receive a supplement related to property tax-rate reduction legislation passed in 2006. Because many ISD deposits into TIFs are a function of the captured appraised value multiplied by a district's current tax rate, legislators were concerned that the new lower tax rates would result in significantly decreased school district contributions to TIRZ funding—which sometimes finances bond and other forms of debt service. To address this concern, the Texas Legislature required ISDs to contribute to their TIRZs at their 2005 tax rates, if their TIRZ contributions are based solely on their current tax rates as specified in their TIRZ agreements. Also, to ensure this requirement did not result in a major cost to ISDs, a state supplement was authorized to hold the districts harmless. The supplement is calculated by taking the difference between the M&O tax rate and the 2005 tax rate, and multiplying it by the TIRZ captured appraised value. In fiscal year 2011, 19 ISDs received the supplement at a cost of $32.5 million in General Revenue Funds.

The concern leading to the requirement that ISDs contribute to their TIRZs at 2005 tax rates, and the related hold harmless supplement, may be re-evaluated in light of current conditions. **Figure 2** shows the TIRZ financial status and state supplements associated with ISDs receiving the supplement in fiscal year 2011, and an estimate of the 2011–12 biennial supplement funding. TIRZs in which 10 ISDs participate experienced ending balances greater than the fiscal year 2011 school district supplement, as well as the estimated 2011–12 biennial supplement.

Figure 3 shows that some ISDs benefit from TIRZ agreements in which more than half of the school district's contribution is returned to the district to finance facility construction and/or modifications, or is used to support school facilities development through a TIRZ. These range from the Carrollton-Farmers Branch school district TIRZ #1, in which 65 percent of the district's TIRZ contribution reverted back to the district for education facility funding, to the 100 percent that benefitted primarily the Katy and Humble ISDs. Contribution amounts returned to or benefiting ISDs are, generally, much greater than the district's supplement. In these cases, a supplement associated with the 2005 tax rates is unnecessary because their tax increment contributions primarily benefit the ISDs.

Recommendation 1 would amend the Texas Education Code, Section 42.2514, to eliminate the supplement for ISDs that use more than half of their TIRZ contributions for facility development, and suspend it for all other districts during the 2014–15 biennium. As a result, the state would not provide an unnecessary funding stream to ISDs that represents a significant cost to the General Revenue Fund.

The Keller, Southside, Houston #9, Farmers Branch #2, and Mesquite #2 TIRZs showed ending fund balances less than the estimated biennial supplement. In these cases, the loss is less than 17 percent of their zone's annual revenue, indicating that suspending the supplement for two years would not cause a financial hardship. By amending their TIRZ agreements, the four ISDs could offset the loss, or the other taxing entities could do so to provide more funding for reinvestment zone projects. The City of Tyler's reinvestment zone also showed a fiscal year 2011 ending balance that is less than the biennial supplement; however, the City of Tyler has indicated that the TIRZ will terminate in August 2013 under its current project plan, so after that point supplemental funding will no longer be needed.

To ensure that the suspension of the supplement does not adversely affect ISDs, the Texas Tax Code, Section 311.013(n), requiring districts to contribute to their TIRZs at the 2005 tax rate, would be removed for those ISDs that would no longer receive the supplement. Also, the requirement would be suspended for the 2014–15 biennium for all other ISDs whose supplement would be suspended during that period.

Changing these requirements would allow ISDs to base their contributions on their current tax rates, or some other TIRZ contribution arrangement agreed to by the city and school district. Recommendation 2 would amend Texas Education Code, Section 42.2514, to prevent ISDs that have not received the supplement as of calendar year 2012 from claiming it in the future. Doing so would prevent districts that have not received a TIRZ-related supplement from

FIGURE 2
TAX INCREMENT REINVESTMENT ZONE FINANCIAL DATA AND SCHOOL DISTRICT TAX INCREMENT FINANCE SUPPLEMENT
FISCAL YEAR 2011
IN THOUSANDS

SCHOOL DISTRICT	CITY	TIRZ NUMBER	BEGINNING BALANCE	REVENUE	EXPENDITURE	ENDING BALANCE	ESTIMATED BIENNIAL SUPPLEMENT
Arlington	Arlington	1	$6,561.9	$1,300.6	$1,915.7	$5,946.8	$450.2
Arlington	Grand Prairie	2	$2,308.6	$6,762.5	$2,252.8	$6,818.3	$1,379.5
Alvin	Pearland	2	$6,884.6	$14,736.0	$17,346.9	$4,273.7	$10,176.6
Birdville	North Richland Hills	1	$944.4	$218.7	$152.9	$1,010.2	$73.1
Carrollton-Farmers Branch	Farmers Branch	1	$(85.2)	$1,784.6	$1,719.3	($41.0)	$503.5
Carrollton-Farmers Branch	Farmers Branch	2	$(45.6)	$95.2	$86.6	($32.9)	$29.7
Carrollton-Farmers Branch	Irving	1	$2,420.7	$17,485.6	$16,713.3	$3,192.9	$6,446,5
Frisco	Frisco	1	$2,817.4	$24,131.8	24,396.7	$2,552,5	$5,773.9
Grapevine-Colleyville	Colleyville	1	$12,498.4	$4,941.6	$5,076.6	$12,363.5	$2,053.9
Grapevine-Colleyville	Grapevine	1	$31,137.3	$6,048.9	$5,135.7	$32,050.5	$2,102.5
Grapevine-Colleyville	Grapevine	2	$6,846.1	$4,308.3	$3,409.6	$7,744.8	$2,087.6
Houston	Houston	1	$1,895.9	$3,602.7	$3,789.5	$1,709.1	$845.4
Houston	Houston	2	$25,984.0	$24,777.8	$27,108.5	$23,653.2	$4,657.7
Houston	Houston	3	$14,444.2	$11,333.7	$9,545.5	$16,232.4	$3,658.2
Houston	Houston	4	$0.0	$23,598.0	$23,598.0	$0.0	$6,159.2
Houston	Houston	5	$3,817.7	$4,095.7	$6,718.0	$1,195.4	$689.7
Houston	Houston	7	$11,811.1	$29,300.6	$6,284.7	$34,827.0	$1,232.6
Houston	Houston	8	$1,400.7	$3,247.1	$3,732.3	$915.5	$260.1
Houston	Houston	9	$827.2	$1,652.5	$2,243.4	$236.3	$406.8
Houston	Houston	12	$450.3	$1,163.9	$1,167.9	$446.3	$312.7
Houston	Houston	13	$2,443.4	$4,333.6	$2,271.1	$4,505.6	$226.3
Humble	Houston	10	$9,990.6	$15,814.1	$23,027.8	$2,686.0	$3,161.0
Katy	Katy	1	$2,604,8	$2,497.5	$2,530.8	$2,571.4	$1,414.7
Keller	Keller	1	$39.8	$3,212.6	$3,178.6	$73.8	$961.4
Mesquite	Mesquite	1	$0.0	$296.9	$296.9	$0.0	$102.1
Mesquite	Mesquite	2	$6,952.2	$2,814.9	$1,543.4	$8,223.7	$1,062.9
Midlothian	Midlothian	1	$16,622.7	$8,653.4	$6,699.1	$18,577.0	$3,806.0
Northwest	Fort Worth	2a	$1,122.4	$1,055.9	$691.9	$1,487.0	$364.5
Northwest	Fort Worth	2b	$154.2	$305.2	$301.8	$157.7	$186.1
Plano	Plano	2	$9,092.9	$5,100.8	$3,643.8	$10,549.9	$1,272.4
Southside	San Antonio	6	$605.3	$1,207.3	$1,232.0	$38.9	$336.3
Temple	Temple	1	$9,783.9	$5,729.1	$3,350	$12,163.0	$1,498.8
Troy	Temple	1	$9,783.9	$5,729.1	$3,350	$12,163.0	$25.9
Tyler	Tyler	1	$2,234.2	$790.5	$3,021.8	$2.9	$312.8
Waco	Waco	1	$8,561.7	$4,929.39	$2,462.5	$11,028.5	$1,527.0
Waco	Waco	2	$1,355.3	$87.7	$0.0	$1,443.1	$23.6
Waco	Waco	3	$63.0	less than $0.5	$0.0	$63.5	less than $0.0

NOTES: Amounts for Katy reflect the Katy Development Authority's School District Debt Fund, which receives all but $30,000 of the school district's annual tax increment reinvestment zone (TIRZ) contribution.
Biennial supplement estimates for Temple ISD and Waco ISD are based on the projected fiscal year 2012 supplements, which Texas Education Agency indicates are 15 percent more than their fiscal year 2011 supplements.
Shown above are those school districts that benefited from both the supplement and the TIRZ property value deduction. Another 14 districts benefited only from the property value deduction.
SOURCE: Legislative Budget Board.

FIGURE 3
TAX INCREMENT CONTRIBUTIONS USED TO BENEFIT SCHOOL DISTRICTS, FISCAL YEAR 2011
IN THOUSANDS

SCHOOL DISTRICT	CITY	TIRZ NUMBER	PERCENTAGE OF TIRZ CONTRIBUTION BENEFITTING DISTRICT	DISTRICT CONTRIBUTION BENEFITTING DISTRICT	ANNUAL SUPPLEMENT
Alvin	Pearland	2	75%	$11,783.9	$5,088.3
Carrollton–Farmers Branch	Farmers Branch	1	65%	$1,096.3	$251.7
Carrollton–Farmers Branch	Irving	1	67%	$8,969.2	$3,223.2
Frisco	Frisco	1	75%	$9,396.9	$2,867.0
Houston	Houston	4	67%	$15,717.4	$3,079.6
Humble	Houston	10	100%	$9,262.9	$1,580.5
Katy	Katy	1	100%	$2,497.5	$707.4
Northwest	Fort Worth	2a	67%	$396.2	$182.3
Northwest	Fort Worth	2b	67%	$202.3	$93.1
Plano	Plano	2	88%	$3,615.1	$636.2

Notes: Tax increment reinvestment zone (TIRZ). Amounts for Katy reflect the Katy Development Authority's School District Debt Fund, which receives all but $30,000 of the school district's annual tax increment reinvestment zone (TIRZ) contribution.
Source: Legislative Budget Board.

taking advantage of the opportunity before changes in statute implemented under Recommendation 1.

Recommendation 3 would include a contingency rider in the 2014–15 General Appropriations Bill directing the Texas Education Agency (TEA) to withhold the state supplement for two years and deduct an amount equal to the supplement from Foundation School Program payments to the affected ISDs.

TIRZ-RELATED PROPERTY VALUE ADJUSTMENTS

Another state-provided benefit accrues to ISDs participating in TIRZs established before fiscal year 2000. These districts either receive increased state funding, or pay lower recapture payments, because participation in a TIRZ established at that time results in an adjustment to property value and M&O tax revenue used to calculate state school finance formulas. The first adjustment is based on subtracting the school district's captured value from its total taxable property value determined by the Comptroller's Property Value Study. The Study is the Comptroller of Public Accounts (CPA) determination of a school district's property value after analyzing locally appraised values and real estate market data. The second adjustment results from subtracting a school district's M&O tax collections into a TIRZ from the M&O tax collection amount used to calculate recapture payments to the state from ISDs.

The Texas Government Code, Section 403.302, stipulates limits related to the size and duration of the TIRZs under which ISDs can get the property value adjustment. The statute limits the number of years for which the ISD may receive the deduction to the duration specified in the TIRZ's financing plan in place before September 1, 1999. CPA requires ISDs to submit a form that identifies the property value adjustment that a school district should receive due to participation in a TIRZ. The form checks for property value adjustment eligibility by asking if the TIRZ boundaries are those that existed on September 1, 1999. However, it does not ask if the duration is the one specified in the financing plan approved before that date. Also, CPA does not have a thorough system to check if the zone's duration was changed by modifications in TIRZ financing plans or agreements occurring after September 1, 1999. As a result, CPA could certify inaccurate TIRZ property value adjustments to TEA—which uses those certifications to determine state funding to ISDs, or the amounts that should be recaptured from the districts.

Recommendation 4 would amend Texas Government Code, Chapter 403, to require CPA to review TIRZ local agreements, financing plans, and amendments to those documents, for those TIRZs in which ISDs participate in order to identify zone sizes and durations that were in place before September 1, 1999. Also, the TIRZ property value adjustment form should indicate if the duration of the zone

was extended after September 1, 1999. In addition, the recommendation would require CPA to take any other steps necessary to ensure ISDs are receiving only the property value deductions to which they are entitled. For example, CPA could contact the entities administering TIRZs for information on TIRZ boundary changes and early expirations.

CPA should use this information to verify if ISDs are receiving only the amount of reinvestment zone property value deductions allowed by state law. If a TIRZ property value adjustment form inaccurately identifies the amount to be deducted from a school district's total property value, CPA should notify the school district of the inaccuracy and of any adjusted amount that will be deducted and certified to TEA.

INFORMATION PROVIDED TO SCHOOL DISTRICT

A 2011 Legislative Budget Board survey of ISDs receiving the TIRZ-related property value offset found that some school district officials do not understand state law provisions regarding changes in the size or duration of the zones. Two ISDs indicated that the size and duration of the TIRZs in which they participate were enlarged and extended after fiscal year 1999. They had agreed to changes made by the governing body of TIRZ, providing it had no adverse effect on their state education funding.

This indicates an uncertainty about the effect that size and duration amendments have on property value offsets or on the state supplement. Also, school finance statutes related to TIRZs are complex and difficult to interpret. One factor contributing to this uncertainty is that the state does not inform ISDs about all of the statutory provisions governing TIRZs, and the extent that changes to a TIRZ boundary or term affect their state education funding.

Recommendation 5 would amend the Texas Tax Code, Section 311, to require CPA, by October 1 of the first year of each biennium, to inform all ISDs receiving TIRZ-related financial benefits of the state law provisions governing those benefits. This information would help make districts aware of those provisions as they relate to changes in the size or duration of TIRZs so that ISDs have a clear understanding of the extent to which such changes affect their TIRZ-related property value and M&O tax collections adjustments, and the state supplement.

FISCAL IMPACT OF THE RECOMMENDATIONS

Implementation of Recommendation 1, related to ending the state supplemental funding, would result in a savings of $64.0 million in General Revenue Funds for the 2014–15 biennium. The estimate is based on the fiscal year 2011 supplement of $32.5 million. Also, the $17.7 million estimated savings in fiscal year 2016 and thereafter is based on the fiscal year 2011 supplement paid to ISDs that apply more than half of their TIRZ contribution to financing their educational facility development. Recommendation 2 would result in savings to the General Revenue Fund to the extent that ISDs that have not received the supplement so far would be prevented from doing so in the future; however this potential savings cannot be estimated. Savings associated with Recommendation 3, to include a TEA contingency rider that withholds payment of the supplement for the 2014–15 biennium, is reflected in the $64.0 million cost avoidance by implementing Recommendation 1. Recommendations 4 and 5, requiring CPA to review TIRZ agreements and inform ISDs about statutory provisions governing TIRZs, can be implemented with the agency's current appropriations.

FIGURE 4
FIVE-YEAR FISCAL IMPACT
FISCAL YEARS 2014 TO 2018

FISCAL YEAR	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE FUNDS
2014	$32,000,000
2015	$32,000,000
2016	$17,700,000
2017	$17,700,000
2018	$17,700,000

SOURCE: Legislative Budget Board.

The introduced 2014–15 General Appropriations Bill does not include any adjustments as a result of these recommendations.

OVERVIEW OF STATE FINANCIAL MONITORING SYSTEMS IN TEXAS PUBLIC SCHOOLS

Financial oversight of public schools, including school districts and charter schools, occurs through four systems employed by two state agencies, the Texas Education Agency and the Comptroller of Public Accounts. The systems use financial information reported by public schools, through the Public Education Information Management System and their Annual Financial Report, to monitor specific performance measures and assess ongoing financial viability. Each system has been designed to function independently of one another. The financial monitoring systems are intended to provide stakeholders with a tool to evaluate and measure the effectiveness and financial stewardship of public schools.

The four financial monitoring systems are the School Financial Integrity Rating System of Texas, Financial Solvency Review, Financial Allocation Study for Texas, and requirements that must be met in order to declare financial exigency.

FACTS AND FINDINGS

- ♦ The four financial monitoring systems use data reported by public schools through the Public Education Information Management System and their Annual Financial Report.
- ♦ The School Financial Integrity Rating System of Texas was implemented to rate the reliability of public schools' financial management practices and use of resources.
- ♦ The Financial Solvency Review was implemented to anticipate future solvency issues that public schools may face.
- ♦ The Financial Allocation Study for Texas rates how efficient and effective a public school is at using its financial resources to achieve academic results.
- ♦ The requirements to file for Financial Exigency track school districts that declare exigency and require minimum declaration standards that districts must meet.
- ♦ A sample of public schools was selected and compared across School FIRST, the Financial Solvency Review, and school districts that declared financial exigency. The results of the analysis concluded that there is some correlation between public schools receiving a Standard Achievement or Substandard Achievement rating on School FIRST and those appearing on TEA's Financial Solvency Review list.

DISCUSSION

Every public school in Texas is statutorily required to submit data to the Texas Education Agency (TEA) through the Public Education Information Management System (PEIMS) and the Annual Financial Report (AFR). Four financial monitoring systems use this data as the basis for determining the effectiveness of public schools' financial management practices, financial stewardship, and ongoing financial viability. TEA developed and administers three of the systems and the Comptroller of Public Accounts (CPA) developed and administers the fourth system. **Figure 1** shows the four state monitoring systems that process the financial information.

PEIMS DATA REPORTING AND THE ANNUAL FINANCIAL REPORT

According to the Texas Administrative Code, PEIMS consists of all data submitted to TEA by school districts, charter schools, campuses, and other educational organizations and entities. The primary categories of data collected relate to the organization, financial information, staff, and students. PEIMS is an automated method the state has been using since school year 1987–88 to collect data within the following structure:

- standard definitions, codes, formats, procedures, and dates of collection;
- standard edit procedures;
- standard file/record submission requirements;
- an established database design; and
- a production system to format and load data into TEA's database.

Data standards are established by the Commissioner of Education in accordance with Texas Education Code, Section 42.006, and are published annually by TEA. The data standards include the following elements:

FIGURE 1
FOUR FINANCIAL MONITORING SYSTEMS FOR TEXAS PUBLIC SCHOOLS, FISCAL YEAR 2012

SYSTEM	AGENCY	YEAR LAUNCHED	PURPOSE	DATA COLLECTED	OUTPUT
School Financial Integrity Rating System of Texas (School FIRST)	Texas Education Agency	2001	To measure the effectiveness of financial reporting and related management practices that promotes successful financial stewardship.	• PEIMS Data • Annual Financial Report (Audit) • Accreditation Status	Rating Assigned*
Financial Solvency Review	Texas Education Agency	2009	To anticipate whether public schools may face future solvency issues.	• PEIMS Data • Annual Financial Report (Audit)	Financial Solvency Review list (currently 24 on list)
Financial Allocation Study for Texas (FAST)	Comptroller of Public Accounts	2009	To identify public schools that achieve high academic results and cost-effective operations based on a spending index and academic performance.	• PEIMS Data • Student Assessment • National Center for Education Statistics	1 to 5 star rating
Financial Exigency Requirements	Texas Education Agency	2011	To track school districts that file for financial exigency and require that they meet certain requirements established by the Texas Education Agency.	N/A	Financial Exigency list** (currently seven on list)

*School FIRST ratings for public schools – 1. Superior Achievement, 2. Above Standard Achievement, 3. Standard Achievement, 4. Substandard Achievement, 5. Suspended – Data Quality.
**Financial Exigency applies only to school districts since charter schools are not bound by teacher contractual agreements.
Source: Texas Education Agency.

- descriptions of the data collections and submission requirements;
- descriptions of data elements and the codes used to report them;
- detailed responsibilities of public schools, education service centers, and TEA in connection with the data submission processes, including each deadline for submission and resubmission; and
- descriptions of the data submission requirements, including submission record layout specifications and data edit specifications.

PEIMS has four submission cycles. The first submission is a snapshot as of the last Friday in October of each year. The results are available in February and include information on students, staff, the organization, and current year budget. The second, or midyear submission, is available in March and includes the prior year's actual financial information. The third submission, or end of year/summer submission, is available in late September following the end of the school year and includes attendance, course completion, and disciplinary data. The fourth, or extended year submission, is available in late October following the end of the school year and includes student data for extended year services and special education.

The Texas Education Code, Section 44.008, requires every Texas public school to have an annual audit of their financial statements performed by an independent, licensed, certified public accountant registered with the Texas State Board of Public Accountancy, in accordance with Generally Accepted Auditing Standards (GAAS). The annual financial audit is conducted on an organization-wide basis, including all fund types and account groups. As part of the audit, the Seventy-fourth Legislature passed legislation requiring an additional audit requirement to test the accuracy of fiscal data reported through PEIMS throughout the year. The Texas Education Code, Section 44.008(b), states that audit procedures performed on PEIMS are to be documented in the audit working papers, and a separate report is not required. Internal reporting controls are examined and assessed as part of the audit and information reported through PEIMS is required

to be examined and compared with amounts in the audit for accuracy.

Based on the results of the audit, the auditor issues an opinion on the accuracy of the school's financial statements. The information from the annual financial audit is submitted to TEA, in the form of an AFR as both a data file and a printed copy. Information included in the AFR, along with information reported through PEIMS, is used to determine public schools' School FIRST rating and Financial Solvency Review. During school year 2010–11, 1,026 school districts (99.7 percent) received an unqualified audit opinion, meaning financial statements are substantially correct. Three school districts (0.3 percent) received an opinion other than unqualified, or not substantially correct. Charter schools received 188 (97.0 percent) unqualified opinions, three (1.5 percent) received an opinion other than unqualified, and three (1.5 percent) received a suspended rating because no data was received by TEA.

TEA's Division of Financial Audits reviews each public school's AFR. If an auditor's report (compliance report and/or internal controls report) disclose areas of noncompliance with laws, rules, or regulations and questioned amounts, or material weaknesses, TEA requires the school to respond to any such findings and recommendations with TEA's Division of Financial Audits. Public schools can choose either a June 30 or August 31 fiscal year end. The AFR is due not later than 150 days after the end of the fiscal year. The due dates to file the AFR with TEA are:

- November 27 for a June 30 fiscal year; or
- January 28 for an August 31 fiscal year.

SCHOOL FINANCIAL INTEGRITY RATING SYSTEM OF TEXAS (SCHOOL FIRST)

Legislation passed by the Seventy-first Legislature, 2001, Texas Education Code, Section 39, requires TEA to annually assign a financial accountability rating to each public school. The Commissioner of Education annually sets the specific procedures and indicators used to determine the ratings. TEA developed School FIRST to measure how effective a public school is at financial management, reporting, and related management practices that promote successful financial stewardship. School FIRST attempts to assess the strength of financial management practices and the effectiveness of decision-making with respect to the allocation of school finances at the local level. School FIRST ratings were issued for school districts beginning in 2003. Charter schools received their first School FIRST ratings in 2009.

The School FIRST ratings TEA issues for a particular year are based on audited financial data and PEIMS information submitted from the previous fiscal year. The Commissioner of Education developed a list of indicators, 20 for school districts and 19 for charter schools that rate the reliability of the financial information reported to TEA. Before the 2012 ratings, School FIRST had 22 indicators for school districts and three for charter schools. The increase in indicators for charter schools aligns the rating system and level of accountability for charter schools to be comparable with school districts. TEA issues a preliminary rating within 150 days of the school district or charter school submitting its AFR.

The 2012 School FIRST ratings for school districts during school year 2010–11 include:

- Superior Achievement, 900 (88 percent);
- Above Standard Achievement, 86 (8 percent);
- Standard Achievement, 22 (2 percent);
- Substandard Achievement, 21 (2 percent); and
- Suspended – Data Quality not reliable, 0.

The 2012 School FIRST ratings for charter schools during school year 2010–11 include:

- Superior Achievement, 77 (40 percent);
- Above Standard Achievement, 49 (26 percent);
- Standard Achievement, 37 (19 percent);
- Substandard Achievement, 25 (13 percent); and
- Suspended – Data Quality not reliable, 3 (2 percent).

Modifications to rules regarding School FIRST have been made so that a school district that declares financial exigency will not obtain the highest rating of Superior Achievement beginning in summer 2013. Charter schools do not declare financial exigency since they are not subject to the same teacher contract requirements as school districts. Refer to **Figure 3** for a list of indicators for school districts and charter schools.

FINANCIAL SOLVENCY REVIEW

The Financial Solvency Review system was authorized by legislation passed by the Eighty-first Legislature, Regular Session, (Texas Education Code, Section 39.0822) to identify schools that may face future solvency issues. As of October

24, 2012, 10 school districts and 14 charter schools were identified as having potential solvency issues.

According to TEA, the review "is designed to alert school districts and open enrollment charter schools to circumstances that could lead to financial insolvency." TEA uses the following data to conduct its financial solvency review:

- annual financial audits for the previous two years;
- PEIMS financial actual data for the previous two school years;
- PEIMS financial budget data for the current year and previous two school years;
- PEIMS staff data for the current year and the previous two school years;
- PEIMS student data for the current year and the previous two school years;
- school district tax rate data; and
- financial information for the first quarter of the current year.

TEA will notify any public school for which the financial solvency review shows one or more of the following:

- a student to staff ratio that is significantly outside the norm;
- a rapid depletion of the general fund balance; or
- a significant discrepancy between submitted budget figures and projected revenues and expenditures.

Per TEA, the public school then has 30 days to respond to, appeal, and submit information that substantiates their financial position and addresses the reason they appear on the solvency review list. If, after this period, they are still considered to be in danger of insolvency, they must submit a plan within 45 days that outlines how they intend to proceed and chart a path toward solvency and economic stability. TEA must then review and approve the plan.

The Commissioner of Education will assign an Accredited-Warned status to a public school that is required to develop and submit a financial plan if it:

- fails to submit a financial plan to avoid a projected deficit;
- fails to get approval from TEA for a financial plan or modified financial plan;
- fails to comply with a TEA-approved financial plan; or
- TEA determines in a subsequent school year, based on financial data submitted, that the approved plan is no longer sufficient or is not appropriately implemented.

FINANCIAL ALLOCATION STUDY FOR TEXAS (FAST)

The Texas Education Code, Section 39.0821, passed by the Eighty-first Legislature, 2009, directed CPA to develop a financial monitoring system to identify public schools that use resource allocation practices that contribute to high academic achievement and cost-effective operations. Based on this directive, CPA developed FAST. The system has produced three reports during 2010, 2011, and 2012. The report is released annually in September. The ratings are based on the financial and academic information reported for the previous fiscal year.

FAST compares the results of math and reading scores reported on the Texas Assessment of Knowledge and Skills (TAKS) test with the amount of costs per student that public schools spend to achieve these results. Public schools are then matched with "peers" that have similar demographic, economic, and cost characteristics so that they can judge how well they are doing relative to other schools in their peer group. FAST uses a three-year average for both academic measures and spending. The goal is to examine the way public schools allocate their resources and compare the relationship between spending and student achievement. The highest rated public schools are those that have been identified as low spending while achieving high academic success. FAST promotes the use of "best practices" that help to achieve primarily cost savings. Costs that FAST calculations use include:

- the operating cost per student;
- the operating cost per program; and
- the staffing cost per student.

A public school is assigned from one to five stars based on their spending index and academic progress percentiles. FAST adjusts for differences among peer groups so that cost drivers are similar across public schools. The study excludes transportation and food service costs in the analysis since these costs often vary widely. Similarly, the system adjusts for teacher and staff wages so that each public school that is being compared has similar cost drivers. Most of the recommendations from FAST focus on cost savings, with

fewer recommendations being made on how to improve academic success.

The 2012 FAST results include:

- number of 5-star public schools – 45 (4 percent);
- number of 4- to 4½-star public schools – 240 (19 percent);
- number of 3- to 3½-star public schools – 395 (32 percent);
- number of 2- to 2½-star public schools – 326 (27 percent);
- number of 1- to 1½-star public schools – 130 (11 percent); and
- number of public schools receiving less than 1 star – 89 (7 percent).

Information for the study is made available to CPA through the University of Texas at Dallas (UT Dallas) education research center, Texas A&M University in College Station, and the Ray Marshall Center at The University of Texas at Austin. The information is made available to UT Dallas education research center through TEA with data from PEIMS.

FAST has a composite academic progress percentile scoring system ranging from less than 20 for low performing public schools, up to 80 to 99 for those that are the highest performing. Five stars have a rating between 80 to 99 and a spending index of "Very Low." A one-star public school has a composite rating of less than 20 and a "Very High" spending index. However, a public school with a "Very High" spending and a composite rating of 80 to 99 (high achievement), and a district with "Very Low" spending and a composite rating of less than 20 (low achievement) both earn a three star FAST rating. Public schools are grouped with "fiscal peers." The study attempts to make comparisons of public schools "that operate in similar cost environments, are of similar size and serve similar students." **Figure 2** shows the FAST scoring system.

FINANCIAL EXIGENCY

Financial exigency is defined as "the financial position of a school district as a whole is such that its financial resources are insufficient to support the school district's instructional programs or the district is unable to finance the full compensation of staff for the current or succeeding fiscal year." The primary reason that school districts declare financial exigency is to reduce personnel costs. The declaration allows a board of trustees of a school district to terminate term contracts that have been signed with teachers. Charter schools are not subject to the same requirements as school districts since they are not required to enter into contractual agreements with teachers.

Before November 2011, there were no reporting requirements, tracking, or monitoring of school districts that declared financial exigency. The Texas Education Code, Section 44.011, amended by Senate Bill 8 passed by the Eighty-second Legislature, First Called Session, 2011, requires the Commissioner of Education to adopt minimum standards concerning financial conditions that must exist for the board of trustees of a school district to declare financial exigency. In November 2011, TEA began tracking school districts that declared financial exigency. An October 2012 LBB survey to school districts, with 375 districts responding, reported that 51 had declared financial exigency between school years 2009–10 and 2011–12. Prior to 2009–10, 31 districts reported that they had declared financial exigency.

A school district that declares financial exigency must submit a form stating the reason the board of trustees has made a

FIGURE 2
FAST RATINGS = ACADEMIC PROGRESS PERCENTILES AND SPENDING INDEX

COMPOSITE ACADEMIC PROGRESS PERCENTILE	SPENDING INDEX				
	"VERY HIGH"	"HIGH"	"AVERAGE"	"LOW"	"VERY LOW"
80 to 99	★★★☆☆	★★★⯪☆	★★★★☆	★★★★⯪	★★★★★
60 to 79	★★⯪☆☆	★★★☆☆	★★★⯪☆	★★★★☆	★★★★⯪
40 to 59	★★☆☆☆	★★⯪☆☆	★★★☆☆	★★★⯪☆	★★★★☆
20 to 39	★⯪☆☆☆	★★☆☆☆	★★⯪☆☆	★★★☆☆	★★★⯪☆
Less than 20	★☆☆☆☆	★⯪☆☆☆	★★☆☆☆	★★⯪☆☆	★★★☆☆

SOURCE: Comptroller of Public Accounts.

declaration within 20 days to the Commissioner of Education. To declare financial exigency the district must meet one or more conditions:

- A decrease of more than 20 percent in unassigned General Fund balance per student in weighted average daily attendance over the past two years or a projected reduction of 20 percent compared to the current year.
- A decline in enrollment by more than 10 percent over the past five years.
- A reduction of more than 10 percent in total General Fund total funding per student in weighted average daily attendance over one year or a projected reduction of 10 percent compared to the current year.
- A natural disaster or casualty loss defined as damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual; and that requires expenditures for repair or remediation in excess of 15 percent of the current-year General Fund budget.
- Any of the following, or a combination of the following, that exceeds 15 percent of the current-year General Fund budget: an unanticipated major expense, including significant repair costs; litigation expenses, excluding lawsuits against the state; or tax refunds.
- Any other circumstances approved in writing by the Commissioner of Education.

For fiscal year 2012, six districts declared financial exigency. For fiscal year 2013, as of December 18, 2012, three districts have declared financial exigency, with two districts extending their declarations. Based on information submitted to TEA for the original declarations, all seven districts cite a decrease in fund balance as a reason for declaring exigency. Four of the seven districts also cite a decline in enrollment as a reason for filing. And, three of the seven districts cite a reduction in funding as a reason for filing.

The declaration of financial exigency will expire at the end of the fiscal year that the declaration is made unless the school district's board of trustees adopts a resolution before the end of the fiscal year declaring continuation of the financial exigency for the next fiscal year. Each time a school district's board of trustees adopts a resolution or an extension of financial exigency, the board must notify the Commissioner of Education within 20 calendar days of the adoption. A board of trustees may terminate a financial exigency declaration at any time if it is considered appropriate.

DATA ANALYSIS

LBB performed analysis on the outcomes reported in 2012 for School FIRST, the Financial Solvency Review, and school districts on the financial exigency list maintained by TEA. The public schools selected were compared to determine if there is any correlation in outcomes among the systems examined. FAST was not included as part of the analysis because the components measured in the study, along with outcomes, are divergent from the results produced by the other monitoring systems.

Of the 10 school districts that were included on the Financial Solvency Review list, 7 school districts (70 percent) received a rating of Standard Achievement or Substandard Achievement on School FIRST, although only 4 percent of all school districts were rated as Standard Achievement or below. For charter schools, all 13 (100 percent) of the charter schools that were included on the Financial Solvency Review list received a rating of Standard Achievement, Substandard Achievement, or Suspended due to data quality on School FIRST, with 34 percent of all charter schools rated as Standard Achievement or below. Based on the results, it appears that there is a correlation between school districts and charter schools that receive a Standard Achievement, Substandard Achievement, or Suspended due to data quality rating on School FIRST and those that TEA has determined as having potential solvency issues. In addition, of the six school districts that have declared financial exigency, only one was included on the Financial Solvency Review list, and it had received a Substandard Achievement School FIRST rating.

Figure 3 is a list of 20 indicators for school districts and 19 indicators for charter schools that are used to determine School FIRST ratings. Public schools are assigned points based on the answer to each question. These points are then tallied and each public school is rated based on the scores. Point totals for each rating are Superior 64 to 70, Above Standard 58 to 63, Standard 52 to 57, and Substandard less than 52. To see a list of the ratings for school districts and charter schools refer to **Figure 1**.

FIGURE 3
SCHOOL DISTRICT AND CHARTER SCHOOL INDICATORS, 2012

SCHOOL DISTRICT INDICATORS (20)	CHARTER SCHOOL INDICATORS (19)
• Was the total fund balance less non-spendable and restricted fund balance greater than zero in the general fund?	• Did the Charter School (CS) avoid holds on payments that were not cleared within 30 days as a result of untimely deposits to Teacher Retirement System or Texas Workforce Commission?
• Was the total unrestricted net asset balance (net of accretion of interest on capital appreciation bonds) in the governmental activities column in the statement of net assets greater than zero? (If the District's five-year percentage change in students was 10 percent more)	• Was the total net asset balance in the Statement of Financial Position for the CS greater than zero? (If the CS's five-year percent change in students was a 10 percent increase or more, then the charter school passes this indicator).
• Were there no disclosures in the Annual Financial Report (AFR) and/or other sources of information concerning default on bonded indebtedness obligations?	• Were there no disclosures in the Charter Holder's (CH's) Annual Financial Report (AFR) and/or other sources of information concerning default on debt?
• Was the AFR filed within one month after the November 27 or January 28 deadline depending upon the district's fiscal year end date (June 30 or August 31)?	• Was the CH's AFR filed within one month after the November 27 or January 28 deadline depending on the CS's fiscal year end date (June 30 or August 31)?
• Was there an unqualified opinion in the AFR?	• Was there an unqualified opinion in the CH's AFR?
• Did the AFR not disclose any instances(s) of material weaknesses in internal controls?	• Did the CH's AFR not disclose any instance(s) of material weaknesses in internal controls?
• Was the three-year average percent of total tax collections (including delinquent) greater than 98 percent?	• Are the CS's liabilities less than 80 percent of its assets?
• Did the comparison of PEIMS data to like information in the AFR result in an aggregate variance of less than 3 percent of expenditures per fund type (data quality measure)?	• Did the comparison of PEIMS data to like information in the CS's AFR result in an aggregate variance of less than 3 percent of all expenses (data quality measure)?
• Were debt-related expenditures (net of Instructional Facilities Allotment and/or Existing Debt Allotment) less than $350.00 per student? (If the district's five-year percentage change in students is equal to or greater than 7 percent, or if property taxes collected per penny of tax effort are greater than $200,000 per student)	• Were the CS's debt-related expenses less than $200 per student? (If the CS's five-year percent change in students was a 7 percent increase or more, then the CS receives 5 points)
• Was there no disclosure in the AFR of material noncompliance?	• Was there no disclosure in the CH's AFR of material noncompliance?
• Did the district have full accreditation status in relation to financial management practices? (e.g., no conservator or monitor assigned)	• Did the CS have full accreditation status in relation to financial management practices? (e.g., no monitor, conservator, management team, or board of managers assigned)
• Was the aggregate of budgeted expenditures and other uses less than the aggregate of total revenues, other resources and fund balance in general fund?	• Was the CS's aggregate of budgeted expenses less than the aggregate of budgeted total revenues and cash and investments at beginning of year?
• If the district's aggregate fund balance in the general fund and capital projects fund was less than zero, were construction projects adequately financed? (to avoid creating or adding to the fund balance deficit situation)	• Intentionally blank
• Was the ratio of cash and investments to deferred revenues (excluding amount equal to net delinquent taxes receivable) in the general fund greater than or equal to 1:1? (if deferred revenues are less than net delinquent taxes receivable)	• Was the CS's current ratio for all net asset groups greater than or equal to 1:1?
• Was the administrative cost ratio less than the threshold ratio?	• Was the CS's administrative cost ratio less than the threshold ratio?
• Was the ratio of students to teachers within the ranges shown below according to district size?	• Was the ratio of students to teachers within the acceptable ranges according to CS size?
• Was the ratio of students to total staff within the ranges shown below according to district size?	• Was the ratio of students to total staff within the acceptable ranges according to the CS's size?

FIGURE 3 (CONTINUED)
SCHOOL DISTRICT AND CHARTER SCHOOL INDICATORS, 2012

SCHOOL DISTRICT INDICATORS (20)	CHARTER SCHOOL INDICATORS (19)
• Was the decrease in undesignated unreserved fund balance less than 20 percent over two fiscal years? (if total revenues are greater than operating expenditures in the general fund, then district receives 5 points)	• Was the decrease in the CS's total net assets less than 20% over two fiscal years? (calculation excludes depreciation and amortization)
• Was the aggregate total of cash and investments in the general fund more than zero?	• Was the CS's aggregate total of cash and investments more than zero?
• Did investment earnings in all funds (excluding debt service fund and capital projects fund) meet or exceed the 3-month U.S. Treasury Bill rate?	• Did the CS's investment earnings in all net asset groups meet or exceed the 3-month U.S. Treasury Bill rate?

Indicator 16 (School Districts) Ranges for Ratios

District Size – Number of Students Between	Low	High
Less than 500	7	22
500–999	10	22
1,000–4,999	11.5	22
5,000–9,999	13	22
Equal to or more than 10,000	13.5	22

Indicator 17 (School Districts) Ranges for Ratios

District Size – Number of Students Between	Low	High
Less than 500	5	14
500–999	5.8	14
1,000–4,999	6.3	14
5,000–9,999	6.8	14
Equal to or more than 10,000	7.0	14

Source: Texas Education Agency.

OVERVIEW OF CAREER PATHWAYS IN TEXAS PUBLIC SCHOOLS

Public schools, including school districts and charter schools, are the primary means by which many adolescents and young adults obtain the knowledge and skills that will prepare them for future employment. However, a growing number of business and industry representatives have expressed concerns that public schools are not adequately promoting educational paths that can lead to occupations for which there are projected shortages of qualified applicants. This concern coincides with a growing body of research indicating public school students cannot see a correlation between their educational experiences and the workplace.

Career pathways are considered one solution to improving student career awareness. A career pathway, also referred to as a program of study, is a way of organizing and presenting high school courses and other activities to provide students an educational roadmap to a specific career. It focuses on how career and technical education courses can support students' aspirations for life after high school, typically customized to individual students through personal graduation plans that incorporates postsecondary course options. This method of career and technical education program organization has been shown to increase the amount of college and career planning taking place in schools, to improve student engagement in planning their own futures, and to increase participation in career and technical education courses. The Texas Education Agency has developed an initiative called Achieve Texas that supports implementation of career pathways as the primary organizational framework for career and technical education programs in public schools.

FACTS AND FINDINGS

- Texas employers have expressed concern that public schools are not adequately communicating the value of preparation for occupations experiencing or projected to have shortages of qualified workers.
- Career pathways are considered one solution to improving student career awareness by clearly showing the educational requirements necessary to gain access to certain careers.
- The Texas Education Agency requires each secondary school receiving federal Perkins funds to offer at least three career pathways, with any additional offerings beyond this being voluntary.
- The Texas Education Agency does not collect information regarding the number of career pathways currently offered in public schools beyond the minimum requirement.
- Achieve Texas is a college and career readiness initiative of the Texas Education Agency designed to combine rigorous academics with relevant career education and to promote successful transitions from secondary to postsecondary education through a career pathways framework.

DISCUSSION

Public schools are the beginning of the workforce development pipeline. Within that role, they have a responsibility for making students aware of careers, providing them with knowledge of these career's educational requirements and how course material have application in those careers. However, studies such as Harvard University's *Pathways to Prosperity* have reported that today's public education students are unable to clearly see a connection between what they are studying and how that relates to tangible opportunities in the labor market.

At the same time, Texas business, industry, and economic development representatives are experiencing increasing difficulties finding qualified workers to fill high-demand, high-skill, and high-wage occupations, such as manufacturing jobs. A national report by Deloitte and the Manufacturing Institute showed that 67 percent of manufacturing employers reported a moderate to severe shortage of available, qualified workers. Furthermore, 56 percent anticipate this shortage to increase in the next three to five years. The Texas Workforce Investment Council has also identified the increasing need for workers with appropriate middle skills in a wide range of industries and occupations as a priority issue to be addressed by its system partners. Testimony provided in interim committees by Texas employers and economic development entities expressed concerns that public schools are not doing enough to inform students about these job opportunities and the educational paths necessary to become qualified for

them. They cite this as contributing to future disconnects between workforce supply and demand.

Career and technical education (CTE) courses are the primary means by which students receive career-focused, applied knowledge and skills in public schools. These courses are typically grouped together into coherent sequences that share a common topic. Their use in a high school setting serves two purposes: as a way to explore different careers; or as preparation that begins to train students for a career. There remains debate among stakeholders on which purpose should be emphasized.

CTE courses are classified as electives with students having relatively wide discretion on what CTE courses they may take and when. This freedom of choice provides students the option to pursue their own interests. The opportunity also exists for haphazard course selection minimizing the positive impacts these decisions can have on a student's future goals. This situation can be exacerbated when high schools offer little direction or guidance on how CTE courses can support students' personal career goals.

A 2011 study of Texas public school CTE programs by the Organization for Economic Co-operation and Development supports this assessment. The report noted challenges associated with the current flexible framework in most high school CTE programs and emphasized the necessary role of career guidance to inform student course selection that can better reflect their career interests and aims.

Additionally, research by the Ray Marshall Center at the University of Texas at Austin highlights similar challenges. The Central Texas Student Futures Project is an ongoing initiative to increase the college-going rate of central Texas public school students. This project includes a longitudinal analysis of student-level education and workforce data, coupled with senior exit surveys, that is linked to secondary and postsecondary education, labor market, corrections, and other outcomes data. One of the project's observations identifies a need to explore promising interventions for low-income and Hispanic students that better considers relationships between education, training, and the educational paths to careers.

CAREER PATHWAYS

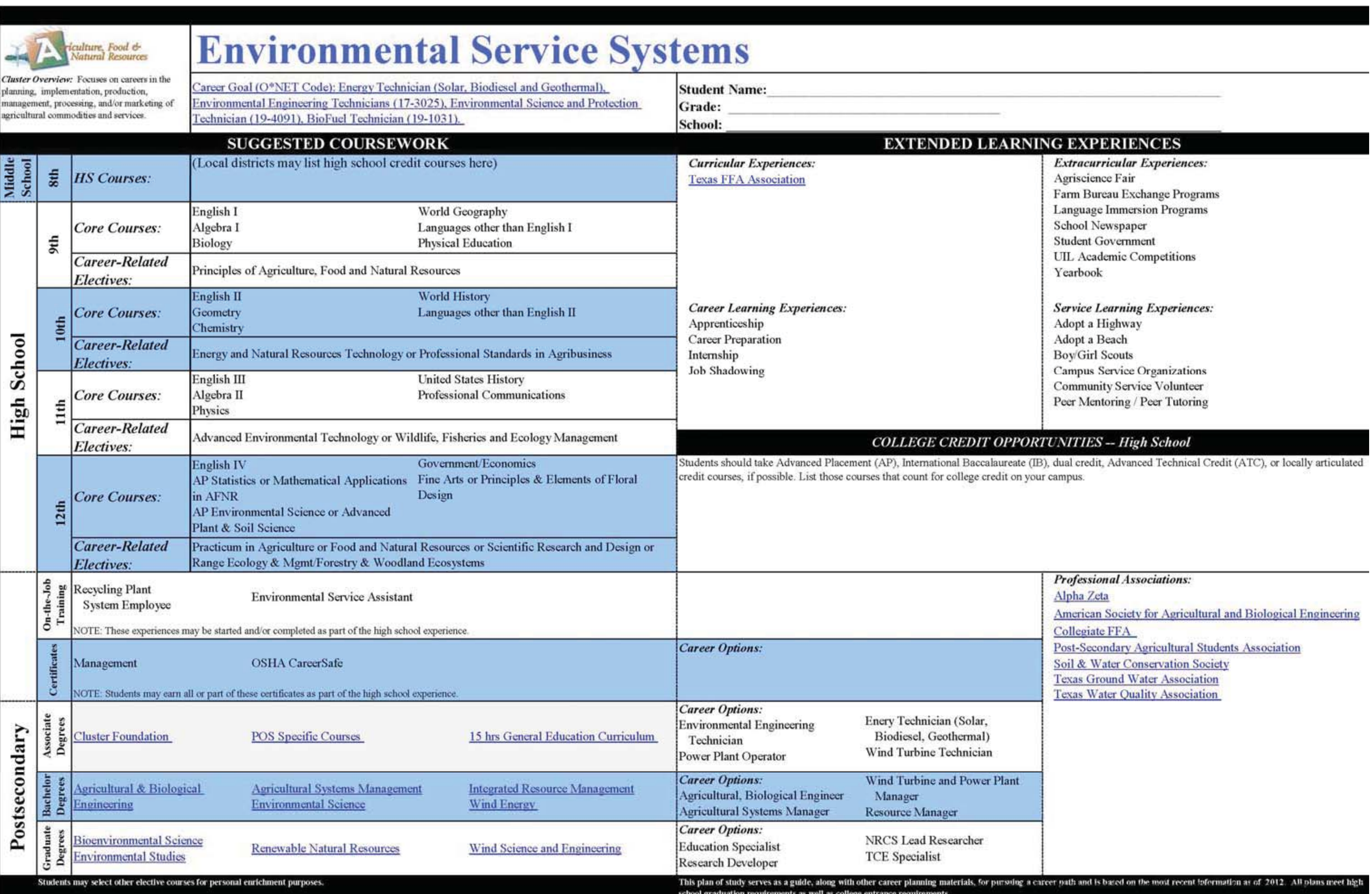
A method of organizing and presenting CTE courses called "career pathways," statutorily referred to as a "program of study," is designed to address this concern by providing students a clear picture of the secondary and postsecondary educational requirements necessary for specific careers. A career pathway is a comprehensive education plan designed to support college and career readiness and developed for an occupational objective. These plans provide strategic alignment of high school academic, technical, and enrichment courses, and identify multiple postsecondary education options. Career pathways encourage maximum use of public school's available resources to support a student's career awareness and preparation. Federal law requires that each career pathway address these components:

- rigorous academic courses based on the Recommended High School Program;
- a coherent sequence of three to four CTE courses that may culminate with postsecondary credit opportunities;
- multiple related postsecondary exit points to provide a seamless transition to a variety of postsecondary education options;
- opportunities for industry-recognized certifications and licensures; and
- extended learning opportunities such as curricular and extra-curricular, work based, service learning, and professional associations.

Career pathway titles can be either specific occupations, such as human resources manager, or fields that contain a range of occupations, such as environmental service systems, as shown in **Figure 1**. Suggested high school coursework is presented with career-related electives listed for each grade level. This includes courses that may provide college credit. Postsecondary degree options are identified along with related career options. Extended learning experiences such as extracurricular activities, service learning opportunities, and professional associations are also identified.

Federal law requires each public school receiving federal Perkins funds to offer at least one career pathway. State education agencies are given discretion on any additional requirements beyond this minimum. The Texas Education Agency (TEA) requires secondary schools to offer at least three career pathways, one from each cluster of CTE courses that share a common theme or topic. Any adoption by public schools beyond this minimum is voluntary. To ensure compliance with this and other federal requirements for CTE, TEA requires public schools to thoroughly describe the program in their annual application for related federal funding. The grant application for school year 2012–13

FIGURE 1
ENVIRONMENTAL SERVICE SYSTEMS CAREER PATHWAY, 2012



Environmental Service Systems

Agriculture, Food & Natural Resources

Cluster Overview: Focuses on careers in the planning, implementation, production, management, processing, and/or marketing of agricultural commodities and services.

Career Goal (O*NET Code): Energy Technician (Solar, Biodiesel and Geothermal), Environmental Engineering Technicians (17-3025), Environmental Science and Protection Technician (19-4091), BioFuel Technician (19-1031).

Student Name: ____
Grade: ____
School: ____

SUGGESTED COURSEWORK

Level	Grade	Type	Courses	
Middle School	8th	*HS Courses:*	(Local districts may list high school credit courses here)	
High School	9th	*Core Courses:*	English I Algebra I Biology	World Geography Languages other than English I Physical Education
		Career-Related Electives:	Principles of Agriculture, Food and Natural Resources	
	10th	*Core Courses:*	English II Geometry Chemistry	World History Languages other than English II
		Career-Related Electives:	Energy and Natural Resources Technology or Professional Standards in Agribusiness	
	11th	*Core Courses:*	English III Algebra II Physics	United States History Professional Communications
		Career-Related Electives:	Advanced Environmental Technology or Wildlife, Fisheries and Ecology Management	
	12th	*Core Courses:*	English IV AP Statistics or Mathematical Applications in AFNR AP Environmental Science or Advanced Plant & Soil Science	Government/Economics Fine Arts or Principles & Elements of Floral Design
		Career-Related Electives:	Practicum in Agriculture or Food and Natural Resources or Scientific Research and Design or Range Ecology & Mgmt/Forestry & Woodland Ecosystems	

EXTENDED LEARNING EXPERIENCES

Curricular Experiences:
Texas FFA Association

Extracurricular Experiences:
Agriscience Fair
Farm Bureau Exchange Programs
Language Immersion Programs
School Newspaper
Student Government
UIL Academic Competitions
Yearbook

Career Learning Experiences:
Apprenticeship
Career Preparation
Internship
Job Shadowing

Service Learning Experiences:
Adopt a Highway
Adopt a Beach
Boy/Girl Scouts
Campus Service Organizations
Community Service Volunteer
Peer Mentoring / Peer Tutoring

COLLEGE CREDIT OPPORTUNITIES -- High School

Students should take Advanced Placement (AP), International Baccalaureate (IB), dual credit, Advanced Technical Credit (ATC), or locally articulated credit courses, if possible. List those courses that count for college credit on your campus.

Postsecondary

Level	Programs			Career Options
On-the-Job Training	Recycling Plant System Employee	Environmental Service Assistant		
	NOTE: These experiences may be started and/or completed as part of the high school experience.			
Certificates	Management	OSHA CareerSafe		*Career Options:*
	NOTE: Students may earn all or part of these certificates as part of the high school experience.			
Associate Degrees	Cluster Foundation	POS Specific Courses	15 hrs General Education Curriculum	*Career Options:* Environmental Engineering Technician Power Plant Operator Enery Technician (Solar, Biodiesel, Geothermal) Wind Turbine Technician
Bachelor Degrees	Agricultural & Biological Engineering	Agricultural Systems Management Environmental Science	Integrated Resource Management Wind Energy	*Career Options:* Agricultural, Biological Engineer Agricultural Systems Manager Wind Turbine and Power Plant Manager Resource Manager
Graduate Degrees	Bioenvironmental Science Environmental Studies	Renewable Natural Resources	Wind Science and Engineering	*Career Options:* Education Specialist Research Developer NRCS Lead Researcher TCE Specialist

Professional Associations:
Alpha Zeta
American Society for Agricultural and Biological Engineering
Collegiate FFA
Post-Secondary Agricultural Students Association
Soil & Water Conservation Society
Texas Ground Water Association
Texas Water Quality Association

Students may select other elective courses for personal enrichment purposes.

This plan of study serves as a guide, along with other career planning materials, for pursuing a career path and is based on the most recent information as of 2012. All plans meet high school graduation requirements as well as college entrance requirements.

Source: Texas Education Agency.

provides a number of questions related to career pathways, but does not ask for how many the public school is offering. The end-of-year performance report for school year 2011–12 also does not require public schools to identify how many are offered.

This approach to organizing and presenting CTE programs has received the endorsement of associations such as the National Association of State Directors of CTE Consortium and research institutions such as the Harvard University Graduate School of Education and Georgetown University's Center on Education and the Workforce. An increasing number of states require their public school's CTE programs to be structured on a career pathways framework. This includes 15 states that require greater than one career pathway and 12 states that require all CTE courses to be offered through career pathways. Some states require that specific percentages of federal funds be spent by public schools through career pathways.

For example, Florida required all of its school districts to convert their CTE programs to career pathways by the end of 2013. Additionally, each career pathway must be based on regional labor market needs for high-demand, high-wage jobs and include an articulated credit opportunity with an institution of higher education. South Carolina also required its schools to develop locally relevant career pathways beginning in 2005. This requirement was established to address the state's high dropout rate and high percentage of workers lacking the skills or postsecondary education needed for success in the twenty-first century.

ACHIEVE TEXAS INITIATIVE

TEA developed a college and career readiness initiative named Achieve Texas to encourage public schools to adopt career pathways. This initiative recommends a package of reforms to strengthen the public school's capacity to prepare its students for both postsecondary education and the workplace.

Achieve Texas developed implementation materials to support public school adoption of career pathways. This includes 122 different customizable career pathway templates covering careers across all types of CTE courses. A substantial amount of supplemental material has also been developed to guide and support implementation. These model templates and recommended implementation steps have been recognized by the National Association of State Directors of CTE Consortium as a model for other states to follow.

Because career pathways are standardized templates and in recognition that individual students have many different routes to educational success, Achieve Texas recommends that high school students have an individualized plan for college and career. This approach is supported by Texas Education Code, Section 28.0212, that encourages school districts to establish a personal graduation plan for each student promoting college and workforce readiness; and career placement and advancement. These plans are a critical component that accompanies and personalizes the model career pathway to work for individual students. They are designed to be flexible, and allow students to change their mind. They are developed with assistance from a teacher or guidance counselor, typically at the beginning of high school and then annually updated. **Figure 2** is the Achieve Texas model of this plan called a Texas Achievement Plan. Practices such as these are mandated in approximately half of all states, with most others, including Texas, having optional programs.

IMPLEMENTATION BENEFITS

LBB staff interviewed CTE directors from school districts that have implemented career pathways. These directors cited this method of organizing and presenting CTE courses as providing a sense of direction and end-goal career focus that their programs previously lacked. The establishment of coherent sequences of CTE courses based on a career-focused objective was noted frequently as a significant benefit of the career pathways model. This encouraged and supported the opportunity for career preparation that is available through CTE programs. Additionally, CTE directors noted that implementing career pathways helped both students and other school staff better comprehend the value of CTE courses and how they can be presented and organized to best support the public school's mission, rather than simply being a collection of courses students take to fill in holes within their graduation plan.

Other benefits of career pathways cited by CTE directors include:

- increases in the number of students participating in CTE;
- stronger collaboration between academic and CTE teachers, including integration of technical and academic concepts across both course types;
- reassessment by school staff of how CTE courses relate to local and statewide workforce needs; and

FIGURE 2
PERSONALIZED GRADUATION PLAN EXAMPLE, 2012

Sample Texas Achievement Plan (TAP)

Name: Taylor Jones **School:** West High School **Career Goal:** Power Generating and Reactor Plant Operator
Cluster: Manufacturing
Pathway: Manufacturing Production Process Development
Postsecondary Goal: Bachelor's degree in engineering, industrial technology, or technology management

9th Grade	10th Grade	11th Grade	12th Grade
Algebra I	Geometry	Algebra II	Precalculus
English I	English II	English III	English IV
Biology	Chemistry	Physics	Environmental Systems
World Geography	World History	US History	Government/ Economics
Languages Other Than English I	Languages Other Than English II	Communication Applications	Fine Arts
Health/PE or Equivalent	Technology Applications	Physical Education or Equivalent	Electronics II
Physics of Instrumentation	Energy Power and Transportation Systems	Electronics I	

Curricular Learning Activities: *SkillsUSA; Technology Students Association (TSA); career preparation learning experiences.*

Extracurricular Experiences: *School Club Officer, Student Government*

Source: Texas Education Agency.

- reconsideration by district staff of the value of a CTE program as compared to the traditional academic program.

One suburban Texas school district implemented career pathways across its district in 2007. This district offers 112 different career pathways with 92 having a postsecondary credit opportunity. In conjunction with this, the district transitioned to a small learning community model with a career focus. Most high schools offer four career-focused clusters with the school physically split into four separate wings. These wings combine both academic and CTE teachers into one teaching unit to encourage strong linkages between applied and academic components.

Another example is from an urban school district that also implemented career pathways. The implementation process resulted in stronger collaborations with industry representatives to develop career pathways leading to careers within local businesses and industry, such as aviation. The CTE director indicated that this framework has helped students to comprehend the necessary steps to achieve their goals that is reinforced throughout their high school experience. Since adoption, this school district has seen a significant increase in the number of students taking CTE courses. From school years 2005–06 to 2011–12, participation increased from 5,760 students to 9,350 (62 percent).

Research by the National Research Center for Career and Technical Education (NRC-CTE) on the value of the career

pathways model supports the perspectives of CTE directors. This includes improved student engagement and an increase in career exploration activities when compared to public schools that did not use career pathways. Furthermore, counselors reported greater student engagement in more career-focused guidance activities after career pathways were implemented.

IMPLEMENTATION CHALLENGES

The NRC-CTE has also identified challenges to implementation of career pathways that can hinder large-scale implementation at state and local levels. These challenges include:

- cultural/mission misalignments existed between secondary and postsecondary, as well as between academic and CTE programs; and
- time and resources are needed to meet all the demands of career pathway development and certification.

OVERVIEW OF GIFTED AND TALENTED EDUCATION IN TEXAS PUBLIC SCHOOLS

Gifted and talented education provides students who have been identified as having high intellectual or creative ability with a supplemental curriculum to their traditional coursework. For 35 years, Texas has provided gifted and talented education to students. Approximately 8 percent of school district and charter school (public school) students in school year 2010–11 were identified as gifted and talented. During this same period, state funding for gifted and talented education was approximately $160.4 million.

The State Board of Education has established compliance measures that gifted and talented education must follow. However, public schools determine what kinds of services are provided for gifted and talented students and there is no state monitoring or auditing of gifted and talented education. Nationally, Texas gifted and talented education is similar in design to those programs operating in other states. Texas is one of 34 states that have laws related to identifying gifted and talented students and/or providing gifted and talented education. In addition, Texas is one of 24 states that specifically allocate state funds for gifted and talented education.

FACTS AND FINDINGS

- ♦ The structure of Texas' gifted and talented education is decentralized with limited state direction. This structure allows public schools to determine what kinds of services are provided for gifted and talented students.
- ♦ The *Texas State Plan for the Education of Gifted/Talented Students* provides a set of compliance measures for public schools to follow. However, gifted and talented education is not monitored or audited at the state level. In addition, public schools do not report how funds are spent or what types of programs and services they provide.
- ♦ African American, Hispanic, and economically disadvantaged students are not proportionally represented in gifted and talented education.
- ♦ The structure of Texas' gifted and talented education is similar in many ways to those programs operating in other states. There is no national strategy or federal mandate in place for gifted and talented education. Thus, all structural and decision-making processes for gifted and talented education are made at the state and local level.

DISCUSSION

Gifted and talented (G/T) education provides services not only to the students who demonstrate advanced academic achievement, but also those who have the ability to achieve at high levels. The Texas Education Code, Section 29.121, defines a G/T student as a child or youth who performs at or shows the potential for performing at a remarkably high level of accomplishment when compared to others of the same age, experience, or environment and who:

- exhibits high performance capability in an intellectual, creative, or artistic area;
- possesses an unusual capacity for leadership; or
- excels in a specific academic field.

The data from public schools regarding G/T education is limited. Information on G/T at the state level is reported to the Texas Education Agency (TEA) through the Public Education Information Management System (PEIMS). Within PEIMS, public schools report the amount of identified G/T students, the amount of teachers classified as teaching G/T classes, and the amount spent on G/T education for a particular school year.

G/T STUDENTS IN TEXAS

In school year 2010–11, 379,789 students, or 7.7 percent, of the total student population of public schools in Texas were identified as G/T. **Figure 1** shows the percentage of students in public schools identified as G/T. Approximately 44 percent of all public schools identified between 5.1 percent and 10 percent of their students as G/T. One goal established by the State Board of Education (SBOE) is that students identified as G/T should be a reflection of the population of public schools. Thus, the gender, ethnicity/race, and economically disadvantaged status of students identified as G/T should closely resemble the overall student population.

In school year 2010–11, 48.6 percent of all students enrolled in Texas public schools were female, and 51.4 percent were male. These percentages compare to 50.9 percent of females and 49.1 percent of males identified in G/T education. In

FIGURE 1
PERCENTAGE OF STUDENTS IDENTIFIED AS GIFTED AND TALENTED IN TEXAS PUBLIC SCHOOLS SCHOOL YEAR 2010–11

PERCENT RANGES	NUMBER OF PUBLIC SCHOOLS	PERCENTAGE OF TOTAL PUBLIC SCHOOLS
0%	163	13.2%
0.1%-5.0%	401	32.7%
5.1%-10.0%	545	44.3%
10.1%-15.0%	95	7.8%
15.1%-20.0%	17	1.4%
20.1%-42.0%	7	0.6%

Source: Texas Education Agency.

addition, of the students identified as G/T in school year 2010–11, 43.4 percent were White, 39.0 percent were Hispanic, 7.8 percent were Asian, and 7.3 percent were African American. As shown in **Figure 2**, if these amounts are compared to the ethnic breakdown of all students enrolled in Texas public schools, Hispanics and African American students are not proportionally represented in G/T. In contrast, both Whites and Asians are disproportionately represented in G/T. Another group of students whose participation rates in G/T are lower than their overall enrollment are economically disadvantaged students. In school year 2010–11, 59.1 percent of all students in Texas public schools were economically disadvantaged compared to only 37.0 percent of students in G/T.

Figure 2 shows enrollment by race/ethnicity and economic status for all students enrolled in public schools in Texas compared to those identified as G/T for school years 2009–10 and 2010–11.

G/T TEACHERS IN TEXAS

In school year 2010–11, there were 6,481 G/T teachers. This represents 1.9 percent of all teachers in the state. This percentage is a slight decrease from the 2 percent of G/T teachers statewide in each of the previous four school years. This is a slightly larger decrease from the 2.3 percent of G/T teachers statewide in school year 2000–01.

G/T FUNDING IN TEXAS

Foundation School Program (FSP) entitlement for G/T education for fiscal year 2011 was $160,379,759. This represents 0.46 percent of total FSP maintenance and operations entitlement. G/T entitlement consists of a Tier 1 allotment equal to the public school's adjusted allotment multiplied by 0.12 for each identified student served in a G/T education, subject to a statutory cap of 5 percent of total students. Additional state funding for G/T is generated through other portions of the FSP.

It is important to note that G/T funding is in addition to the basic entitlement. This funding is in acknowledgment of the potential cost differential of providing specialized instruction to G/T students, similar to the bilingual/English as a second language program, and special education students served in a mainstream setting. Thus, a G/T student generates both the basic amount of FSP "regular student" funding as well as the additional G/T entitlement.

For fiscal year 2011, entitlement was generated by 219,899 students identified in G/T in public schools. This amount differs from the amount of students identified by public schools during this same period. There is a difference because the state caps funding at 5 percent of a public school's student population. However, public schools statewide identified 7.7 percent of students as G/T.

FIGURE 2
GIFTED AND TALENTED ENROLLMENT BY RACE/ETHNICITY AND ECONOMIC STATUS, SCHOOL YEARS 2009–10 AND 2010–11

	2009–10		2010–11	
GROUPS	PERCENTAGE OF TOTAL STUDENTS	PERCENTAGE OF TOTAL STUDENTS IDENTIFIED AS G/T	PERCENTAGE OF TOTAL STUDENTS	PERCENTAGE OF TOTAL STUDENTS IDENTIFIED AS G/T
African American	13.0%	7.4%	12.9%	7.3%
Asian	3.3%	7.4%	3.4%	7.8%
Hispanic	49.5%	38.0%	50.3%	39.0%
White	31.9%	44.7%	31.2%	43.4%
Other	2.1%	2.4%	2.2%	2.5%
Economically Disadvantaged	58.9%	36.2%	59.1%	37.0%

Source: Texas Education Agency.

During school year 2010–11, public schools reported expenditures of approximately $400 million through the G/T education. This amount constituted 1.4 percent of total public school operating expenditures during that school year.

Figure 3 shows the FSP G/T entitlement for fiscal years 2009 to 2011, which includes funding for all public schools. **Figure 4** shows public school expenditures reported for G/T education during school years 2008–09 to 2010–11.

FIGURE 3
FOUNDATION SCHOOL PROGRAM ENTITLEMENT FOR GIFTED AND TALENTED EDUCATION
FISCAL YEARS 2009 TO 2011

	2009	2010	2011
G/T entitlement (In Millions)	$154.1	$157.3	$160.4
Amount of students funded	212,234	216,182	219,899
Percentage of Foundation School Program Total Maintenance and Operations Entitlement	0.48%	0.46%	0.46%

SOURCE: Legislative Budget Board.

FIGURE 4
PUBLIC SCHOOL ACTUAL ALL FUNDS EXPENDITURES FOR GIFTED/TALENTED EDUCATION
SCHOOL YEARS 2008–09 TO 2010–11

	2008–09	2009–10	2010–11
Amount of students identified	355,801	367,873	379,789
G/T education actual operating expenditures* (In Millions)	$416.9	$418.0	$411.8
Percentage of total actual operating expenditures	1.4%	1.4%	1.3%

*Actual operating expenditure data is from TEA's Academic Excellence Indicator System and corresponds to the previous school year.
SOURCE: Texas Education Agency.

The G/T expenditures reported by public schools are much larger than state funding for the three years shown in **Figure 4**. However, it is difficult to draw conclusions from these amounts for several reasons. First, as previously mentioned, the Texas Education Code caps G/T entitlement at 5.0 percent of a public school's student population. However, the amount of identified G/T students reported by public schools is based on G/T education provided to 7.7 percent of all students statewide. Thus public schools provided G/T education to an average of 151,506 more students per year during this three-year period than earned G/T entitlement. Also, there is no requirement for public schools to indicate what types of programs and services they are including in their reported G/T spending. As a result, it is challenging to effectively compare reported public school spending to state funding for G/T education.

LEGISLATIVE HISTORY

G/T education in Texas originated with the passage of legislation in 1977 that addressed the specific needs of G/T students. Two years later, the Texas Legislature allocated funds for providing services to G/T students through a competitive grant structure administered through TEA. In 1987, the Seventieth Legislature passed legislation that provided funding for G/T education to every school district on a formula basis. The funding formula was set at a weight of 0.047, with an increase to 0.12 established for school year 1990–91. The legislation also capped funding for G/T education at 5 percent of a school district's student population. This same funding formula and cap are still in place as of school year 2011–12 and also now apply to charter schools.

In 1995, the Seventy-fourth Legislature reaffirmed the formula and passed Texas Education Code, Section 42.156, establishing the G/T student allotment. In addition, the Seventy-fourth Legislature passed legislation defining a G/T student and establishing G/T services, as well as state plan assistance. The state plan, which had been adopted by the SBOE five years earlier, became the *Texas State Plan for the Education of Gifted/Talented Students* (the state plan). This plan continues to serve as the guiding document for G/T education in public schools in Texas.

A rider in the General Appropriations Act, 2000–01 Biennium, provided funding for what is now known as the Texas Performance Standards Project. The intent of this program is to develop an assessment system and statewide standards for G/T students at all grade levels. Public school participation in the project and use of these standards is voluntary.

The Eighty-first Legislature, Regular Session, 2009, passed legislation requiring the Commissioner of Education (Commissioner) to adopt standards to evaluate G/T education in public schools. These standards are to determine whether public schools are operating G/T education in accordance with the Texas Performance Standards Project or other comparable programs. As of school year 2011–12,

these standards have not yet been released by the Commissioner.

STATE REQUIREMENTS

The Texas Education Code, Section 29.122, requires each school district to adopt a process for identifying and serving G/T students in Kindergarten through grade 12. Charter schools only have to identify and serve G/T students if they specifically indicated they would do so in their charter. For all public schools the criteria for identifying G/T students and providing services to them are established by the SBOE in the state plan. This plan is to be updated periodically and used for accountability purposes to measure the performance of public schools in providing services to students identified as gifted and talented.

In addition to the requirements found in the Texas Education Code, there are also state requirements for G/T education in the Texas Administrative Code, Chapter 19, Sections 89.1 through 89.5 state that a school district must follow certain criteria of student assessment, professional development, student services, fiscal responsibility and program accountability. Some of these include:

- in grades 1 to 12, qualitative and quantitative data are required to be collected through three or more measures to determine whether a student needs G/T education;
- regular classroom teachers who provide instruction and services for G/T students must have 30 hours of professional development in G/T or complete their 30 hours within one semester. Also, G/T teachers must have an additional six hours of professional development in G/T education annually;
- administrators and counselors who have authority for G/T education decisions must have a minimum of six hours of G/T professional development training; and
- school districts must provide an array of learning opportunities for G/T students in Kindergarten through grade 12 and shall inform parents of the opportunities.

Charter schools also must follow the requirements in the state plan and the Texas Administrative Code if they have elected to provide G/T education for their students in their charter.

Originally established in 1990, the state plan has been periodically revised over the last 22 years with the last revision in 2009. The plan offers an outline for G/T education. It also acts as a tool to assist public schools in providing optimal levels of services to their G/T students. It is organized into five service areas consistent with the requirements in the Texas Administrative Code. These areas include student assessment, service design, curriculum and instruction, professional development, and family/community involvement. Within each of these service areas, the state plan establishes three levels of performance measures from which public schools can measure their programs, which includes "In Compliance," "Recommended," and "Exemplary." Additionally, each level has accompanying criteria to measure its achievement, as shown in **Figure 5**. Public schools are responsible for providing the services detailed in the "In Compliance" column in each service area. The state plan acknowledges that many public schools will provide more comprehensive services and thus the establishment of the other levels of Recommended and Exemplary. **Figure 5** shows an excerpt from the Curriculum and Instruction section of the state plan.

COMPLIANCE WITH THE STATE PLAN

While public schools are required to follow the measures in the "In Compliance" section of the state plan, G/T education is not monitored or audited at the state level. In addition, public schools do not report to PEIMS on G/T education

FIGURE 5
SAMPLE OF TEXAS STATE PLAN FOR THE EDUCATION OF GIFTED/TALENTED STUDENTS, FISCAL YEAR 2009

CURRICULUM AND INSTRUCTION

PUBLIC SCHOOLS MEET THE NEEDS OF GIFTED/TALENTED STUDENTS BY MODIFYING THE DEPTH, COMPLEXITY AND PACING OF THE CURRICULUM AND INSTRUCTION ORDINARILY PROVIDED BY THE PUBLIC SCHOOL.

IN COMPLIANCE	RECOMMENDED	EXEMPLARY
3.3C Opportunities are provided to accelerate in areas of student strengths (19 Texas Administrative Code, Section 89.3(4)).	**3.3R** Flexible pacing is employed, allowing students to learn at the pace and level appropriate to their abilities and skills.	**3.3E** Scheduling modifications are implemented in order to meet the needs of individual students.

Source: Texas State Plan for the Education of Gifted/Talented Students.

services provided to students. Beginning in the 1990s, TEA conducted onsite visits and reviews of school districts to ensure compliance with state regulations. These reviews included ensuring that school districts were following the state plan for G/T education. These onsite visits were called District Effectiveness and Compliance (DEC) reviews. DEC review compliance teams would visit school districts for several days, examine documents, and conduct interviews with local school district officials. Ultimately, the compliance team would write a report that was provided to the local board of trustees. However, in 2004, the DEC reviews were eliminated. School districts were then required to submit a written report to TEA demonstrating compliance in G/T education. These written reports were ultimately no longer required as well and monitoring of G/T education is now locally governed. The Texas Education Code, Section 7.028, requires that the board of trustees of a school district or the governing body of an open enrollment charter school has primary responsibility for ensuring that the public school complies with all applicable requirements of state educational programs including G/T education.

COMPARISONS WITH OTHER STATES

The structure of G/T education in Texas is similar in many ways to those programs operating in other states. Most importantly, there is no national strategy or federal mandate in place for G/T education. Thus, all structural and decision-making processes for G/T are made at the state and local level. This decentralized structure has generated a large variety of services, as each state individually decides whether and to what extent it will provide G/T education. Texas is one of many states that provide limited direction regarding G/T education and allows public schools to determine the kinds of services to provide. **Figure 6** provides a breakdown of the status of G/T education in the 10 most populated states including Texas.

Thirty-four states, including Texas, have laws related to identifying G/T students and/or providing G/T education. Texas is also one of 45 states that define giftedness in statute or regulation. In addition, Texas is one of 30 states that provide public schools with some criteria for identifying G/T students.

States that specify standards or requirements regarding G/T education differ in how they monitor and report the effectiveness of G/T education. Twenty states, including Texas, neither monitor nor audit G/T education. Texas is also one of 13 states that have no requirement that G/T education report services at the state level. Fourteen states do not collect any statistics regarding the amount of students who are identified as G/T. However, many states that require G/T education also require public schools to report to the state on its status. In addition, 10 states publish annual reports on the state of G/T education, 16 states include G/T indicators on public school report cards, and five others publish G/T indicators as part of a larger state report.

FIGURE 6
STATE POLICIES AND FUNDING FOR G/T EDUCATION IN THE TEN MOST POPULATED STATES
SCHOOL YEAR 2010–11

STATE	MANDATES SERVICES	ESTABLISHES MANDATES FOR IDENTIFICATION	MONITORS G/T EDUCATION	AMOUNT OF G/T STUDENTS SERVED	REQUIRES G/T TEACHERS TO HAVE PRE-SERVICE G/T TRAINING	STATE FUNDS ALLOCATED FOR G/T EDUCATION (IN MILLIONS)
California	No	No	No	N/A	No	$44.2
Texas	**Yes**	**Yes**	**No**	**379,789**	**Yes**	$160.4
New York	No	No	No	N/A	No	$0.0
Florida	Yes	Yes	Yes	140,698	No	$267.3
Illinois	No	No	No	N/A	No	$0.0
Pennsylvania	Yes	Yes	Yes	N/A	No	$0.0
Ohio	Yes	Yes	Yes	55,732	No	$69.0
Michigan	No	No	No	N/A	No	$0.0
Georgia	Yes	Yes	Yes	176,485	No	$301.9
North Carolina	Yes	Yes	Yes	173,215	No	$68.1

Note: N/A indicates that this data is not collected by that particular state.
Source: National Association of Gifted Children.

Regarding the structure of G/T education, 21 states, including Texas, require that G/T education be provided beginning in pre-Kindergarten or Kindergarten. Some states require that G/T education include particular components such as differentiated instruction or academic guidance and counseling. However, 39 states, including Texas, do not have such state requirements. Compared to other states, Texas has much more rigorous requirements on the training teachers must receive before educating G/T students. For example, Texas is one of only six states that require teachers to have pre-service training in G/T education. Texas is also one of only five states that require teachers to receive annual professional development.

Funding is similarly diversified across the states. Aside from some federal funds awarded for exceptional programs, G/T education is primarily funded from state and/or local appropriations from educational funds. Texas is one of 24 states that specifically allocate funds at the state level for G/T education. Among these 24 states, there is great variety in their funding formulas. These formulas vary on whether they cap funding at a certain percentage of students and at what percentage, as well as how state funds are disbursed. Funding for G/T education in 17 of the 24 states is provided through weighted funding. However, the other eight states use resource-based or discretionary funding. Overall, in school year 2010–11, only Georgia and Florida provided more total state funding for G/T education than Texas. However, unlike Texas, Georgia has a funding structure with no cap on the amount of G/T students that will be funded. Florida also places a funding cap for G/T students only at the high school level. Finally, during school year 2010–11, Texas identified more G/T students than any other state. Texas public schools provided services to more than twice as many G/T students (379,789) as the next closest state of Georgia (176,485).

G/T PROGRAMS AND SERVICES

While public schools are required to comply with the state plan, there are limited instructions on how they must meet these requirements. As a result, there is great variation in the programs and services provided for G/T students. Public schools, however, are not required to report on how their specific G/T education is structured or what services they offer. Thus, determining how G/T education actually operates is difficult. One method for examining how G/T education operates at the public school level is to look at the school reviews conducted by Legislative Budget Board's Texas School Performance Review (TSPR). These reviews examine the effectiveness and efficiency of the operations of school districts, including G/T education. Using highlights from these reviews, it is possible to gain greater insight into the various ways school districts are implementing the requirements of the state plan. These requirements fall under the categories of student assessment, service design, curriculum and instruction, professional development, and family/community involvement.

STUDENT ASSESSMENT

Student assessment relates to assessment instruments and the methods public schools use to identify G/T students. To comply with the state plan, G/T students must be identified using both quantitative and qualitative information from multiple sources. School districts evaluated by TSPR commonly accomplished this through identification committees. These committees typically consisted of principals, classroom teachers, and/or other administrative personnel. Committees receive nominations for potential G/T students that come from various sources. Some of these sources include teachers, parents, relatives, community members, peers or a combination of some or all of these. The tools used to evaluate students once they were nominated varied by school district. A combination of intelligence tests, state achievement test scores, student portfolios, and recommendations from teachers or parents were used by most school districts. In middle and high school, intelligence tests, teacher checklists, grade point averages, and state achievement test scores were the most used tools for evaluating students for acceptance into G/T education. The most common intelligence tests used by school districts included IQ tests, the Iowa Test of Basic Skills, and the Screening Assessment for Gifted Elementary Students (SAGES). For elementary students, teacher checklists and intelligence tests were the most common evaluation tools. Requiring teachers to complete the Renzulli/Hartman checklist on student learning was the tool most often used to identify elementary students.

Once students were identified, TSPR found most identification committees established a matrix that assigned point values for the various evaluation tools they used. These matrices then determined a final score for each student. However, a few school districts used a case study approach that reviewed each student on an individual basis. This approach took into account the evaluation tools as well as previous school district records and interviews with students, teachers, and parents.

In the area of student assessment, the majority of school districts reviewed by TSPR were found to have inadequate minority representation within G/T education. The measures school districts most often used to successfully increase minority identification in G/T were alternative testing instruments. These included using verbal tests such as the C-Toni to bypass limited English proficiency, the Raven Test which is a non-verbal assessment of visual-spatial reasoning ability. For older students, some school districts used the Aprenda, the Spanish equivalent of the Stanford Achievement Test. A few school districts in which minorities were adequately represented in G/T had removed the nomination process entirely. They simply tested all Kindergarten and grade 1 students to ensure they do not overlook any potential G/T students.

SERVICE DESIGN OF G/T EDUCATION

The service design section of the state plan outlines the expected overall design of G/T education within a public school. This design includes requiring public schools to provide a flexible system of viable service options that are developed and consistently implemented. These service options are established to meet the needs and reinforce the strengths and interests of G/T students. The service designs of G/T education were fairly similar in most school districts evaluated by TSPR.

For elementary grades 1 to 5, the majority of school districts reviewed used differentiated learning and pull-out sessions. Differentiated learning involves keeping all students together in a classroom, but providing G/T students with special instructions, materials, and assignments. The structure of the pullout programs varied by school district. However, these programs always involved G/T students being removed from the general classrooms periodically to receive specialized instruction and engage in various learning activities. Some school districts had pullout classes for G/T students several times per week, while others had them once per week, once per month, or quarterly. In addition, school districts varied in how these pullout classes were structured. Larger school districts often kept G/T students organized by individual grades while smaller school districts often combined several grades or all elementary students together into larger pullout classes.

For middle school students grades 6 to 8, the most common service design found by TSPR was the use of Pre-Advanced Placement (Pre-AP) courses. These courses prepare students to take Advanced Placement (AP) courses in high school. In most school districts, however, these Pre-AP classes were not restricted to G/T students. Some of the other methods most often used by school districts at the middle school level were honors classes and pull-out classes.

At the high school level grades 9 to 12, the service design method typically employed for G/T students were AP classes. Another method often used at the high school level was a dual credit system. This is a system in which a student enrolls in a college course and simultaneously earns college credit and high school credit for the course. One school district worked with their local university and other educational organizations such as museums and nature centers to offer mini-courses specifically for G/T students. These mini-courses covered a variety of subjects such as architecture, art, environmental studies, history, space, and inventions. The use of dual credit courses was limited to school districts that had universities or community colleges in their areas. As with middle schools, however, few school districts restricted AP or dual credit classes to G/T students. Only three of the school districts evaluated by TSPR identified providing any services specifically for G/T students in high school beyond AP and dual credit courses. Of these three school districts, two maintained pull-out courses periodically for G/T students in high school and one other extended G/T education for high school students to include mentorships with members of the community.

CURRICULUM AND INSTRUCTION

The curriculum and instruction section of the state plan requires that public schools meet the needs of G/T students by modifying the depth, complexity, and pacing of the curriculum and instruction ordinarily provided by the public school. Of the school districts evaluated by TSPR, many did not have an adequate curriculum for G/T education at all grade levels. Of those school districts that had an adequate G/T curriculum, there was great variation in how they were structured and implemented. Most school districts with a G/T curriculum developed them in-house and were unique to the school district. Some examples of a G/T curriculum evaluated by TSPR include:

- **A four-pronged program focused on creative, intellectual, academic, and leadership skills.** All elementary schools in the school district followed a common curriculum skill sequence. This sequence included content specific instruction incorporating creative, intellectual, and leadership skills. Students at the middle school level were enrolled in a G/T class with a certified G/T teacher providing instruction

in the four core areas. Using a thematic approach, leadership and creativity were also major components of this program. Finally, AP and Pre-AP courses at the high school level provided students with differentiated instruction.

- **A program with a primary focus on individualized educational plans for each G/T student.** The student provided input into the plan and the student's teachers and parents were also consulted. Activities included writing or designing for school publications, a puzzle or games club, group research projects, or enrichment through music. This program also provided opportunities to G/T students to work outside the standard curriculum through alternative assignments. G/T students could also work with mentors who were members of the community and were engaged in work in which a student had expressed interest.
- **A program in which a theme for the year was selected.** All activities were based either on the selected theme or on core area-related projects assigned to the students. For example, one year the G/T elementary program chose the rainforest theme. Next year, instead of a theme, the G/T teachers chose to assign one major project surrounding American History to the students.
- **A curriculum based on the Texas Essential Knowledge and Skills (TEKS), which are the state standards for what students should know and be able to do.** The program was geared to accelerate, compact, provide greater depth, and expand the content. Strands of technology, creativity, leadership, and artistic talents were integrated throughout four academic core subjects. Program options enabled students to work in flexible grouping patterns and independent investigations. The classroom teacher delivered differentiated instruction. Students in grades 6 to 8 had the opportunity to participate in an advanced academic Humanities Program. This program included specific academic ability courses in language arts, social studies, and technology. These courses had an emphasis on critical, creative, and productive thinking skills. At the high school level, G/T students were clustered into Pre-AP and AP courses.

PROFESSIONAL DEVELOPMENT

The professional development section of the state plan places requirements on the amount of professional development hours for G/T teachers. The state plan requires that teachers complete 30 hours of professional development either before or within one semester of teaching a G/T class. After completing this initial training, G/T teachers must annually complete an additional six hours of professional development in G/T education.

During the course of the reviews by TSPR, some school districts were found to be using G/T teachers who had not completed the required training. TSPR reviews also found that G/T teachers were provided professional development through many sources. These sources included web-based courses, external consultants, regional education service centers, local colleges, or universities and various conferences and workshops held across the state.

FAMILY/COMMUNITY INVOLVEMENT

The family/community involvement section of the state plan requires that public schools involve family and community members in services designed for G/T students. To achieve this goal, public schools must ensure parents are aware of identification policies and learning opportunities for G/T students. In addition, public schools must annually evaluate the effectiveness of G/T education and parents should be included in the evaluation process.

TSPR found that most school districts reviewed had some policy in place to provide parents and the community with information on their nomination process for G/T students and their G/T education program. A variety of dissemination methods were used. These methods included holding open houses, sending informational flyers home with students, mailing letters, publishing G/T information in local newspapers, and/or presenting information on their school district websites.

Finally, TSPR found that some of the school districts reviewed had no evaluation plan in place at all for G/T education. Most school districts that did have evaluation plans were still not in compliance in one of the five areas of the state plan. Many school districts, however, were not compliant in multiple areas.

OVERVIEW OF BILINGUAL AND ENGLISH AS A SECOND LANGUAGE PROGRAMS IN TEXAS PUBLIC SCHOOLS

In Texas, there were more than 838,000 students identified as having limited English proficiency during school year 2011–12. The number of students classified as limited English proficient 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 programs are designed to help the students gain competency in English and be able to participate equitably in school. However, each program employs a different approach to achieve this goal. Bilingual education provides students with instruction in both English and their home language. Instruction in English as a second language programs is conducted in English and is integrated with the use of language acquisition methods, such as thematic and hands-on instruction. Special certifications are required to teach bilingual and English as a second language education. The State Board for Educator Certification issues the special certifications and endorsements required for teaching bilingual education and English as a second language.

The Texas Education Agency monitors and evaluates the performance and effectiveness of the bilingual and English as a second language programs in school districts and charter schools (public schools) on an annual basis. Bilingual and English as a second language programs are monitored using the Performance-Based Monitoring Analysis System. The effectiveness of these programs is assessed based on performance on established bilingual/English as a second language indicators. Based on program performance levels, the Texas Education Agency may select public schools for interventions.

FACTS AND FINDINGS

- The primary distinction between bilingual and English as a second language programs is the language in which instruction is delivered.
- Texas Education Code uses the term limited English proficient to refer to a student whose primary language is other than English and whose English language skills are such that the student has difficulty performing ordinary classwork in English. The Texas Administrative Code almost exclusively uses the term English language learner when referring to these students.
- In school year 2011–12, 16.8 percent of all students were identified as limited English proficient. Spanish was the primary language for more than 90 percent of the students. This was followed by Vietnamese, spoken by approximately 2 percent of limited English proficient students.
- During the 2011–12 school year, 5.3 percent, or 17,232, of the state's 324,001 full-time-equivalent teachers taught in a bilingual or English as a second language program. The number of bilingual and English as a second language students per teacher has increased from 31 to 47 in the last four years.
- In school year 2010–11, public schools received $428.2 million in state funding from the Foundation School Program for bilingual and English as a second language programs. Statewide total expenditures that year for bilingual/English as a second language were $1.2 billion, which included local and federal funds.
- The Texas Education Agency annually monitors and evaluates the performance and effectiveness of bilingual and English as a second language programs and, based on results, identifies public schools for interventions.

DISCUSSION

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. This term is used exclusively in statute to refer to this population of students. However, in recent years education scholars have made an effort to use terminology that is more student-centered. As a result, use of the phrase LEP is in decline. Instead, the term English language learner (ELL) has gained prominence among scholars, and federal and state policy makers. The definition of English language learner is a student who is in the process of acquiring English and has another language as the first native language. Texas Administrative Code uses 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. However, since TEA data reports continue to use the term LEP, this report uses this terminology.

BILINGUAL AND ESL PROGRAMS AND STUDENTS

Texas Education Code, Section 29.053, establishes when bilingual and English as a second language (ESL) programs must be offered. According to TEA rules, any district or charter school with an enrollment of 20 or more LEP 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 LEP students who speak that language in pre-Kindergarten through the elementary grades. However, school districts and charter schools are authorized to offer bilingual programs at grade levels in which bilingual education is not required. All LEP 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** summarizes the requirements regarding when bilingual and ESL programs must be offered.

Texas Education Code, Section 29.058, allows students who do not have limited English proficiency (non-LEP) to participate in the bilingual program. To participate, the student must have the consent of his or her parent/guardian and the public school. The number of non-LEP students cannot exceed 40 percent of the number of students enrolled in the bilingual program.

The primary distinction between bilingual and ESL programs is the language in which instruction is delivered. The goal of both bilingual education and ESL is to enable LEP students to become competent in listening, speaking, reading, and writing in English. In bilingual programs, this is 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.

To identify students needing bilingual or ESL services, a home language survey must be completed for each new student within four weeks of the student's enrollment. Public schools use the home language 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 the student is eligible for a bilingual program, public schools also administer an assessment in the home language to determine the student's oral proficiency level.

Based on the results, the language proficiency assessment committee (LPAC) may classify a student as LEP. Once a student is identified as LEP, the LPAC designates the student's initial instructional placement in the required program. Parents/guardians of LEP students are notified in writing of the student's classification and placement. A parent or guardian must give consent for the student to participate in the bilingual or ESL program.

Participation in bilingual and ESL programs, along with the total LEP student population, is increasing. In February 2011, TEA issued *A Review of High School Completion Rates and Dropout Prevention for Students Identified with Limited English Proficiency*. It reported that the LEP student population increased by 41.7 percent from school years 1999–2000 to 2009–10. The total student population increased by only 21.1 percent in the same 10-year period. The number of students identified as LEP has continued to increase over the past few years. However, the number of LEP students enrolled in public schools is now increasing at a slower rate than overall enrollment. From school years 2008–09 to 2011–12, the number of LEP students increased by 4.7 percent while total enrollment increased by 5.2 percent.

FIGURE 1
REQUIREMENTS FOR PROVIDING BILINGUAL AND ESL PROGRAMS, 2012

	BILINGUAL PROGRAM	ESL PROGRAM
Elementary School	Required in districts or charter schools with an enrollment of 20 or more LEP students in any language classification in the same grade level.	Must be offered to any LEP student for whom a district or charter is not required to offer a bilingual program.
Middle School/Jr. High	Optional	Must be offered to any LEP student for whom a district or charter does not offer a bilingual program.
High School	Optional	Must be offered to any LEP student for whom a district or charter does not offer a bilingual program.

Source: Texas Administrative Code.

Figure 2 shows the number of students identified as LEP and enrollment in bilingual and ESL programs from school years 2008–09 to 2011–12. The number of students enrolled in a bilingual or ESL program increased by 6.9 percent during the four-year period. However, student enrollment in each program has not increased at the same rate. Bilingual program enrollment increased by 10.5 percent during this period. ESL enrollment increased by only 1.6 percent.

In school year 2011–12, there were 838,418 students, or 16.8 percent of all students, identified as LEP. Statewide, 809,854 students, or 16.2 percent of all students, were enrolled in a bilingual or ESL program. Of the students served by either program in school year 2011–12, 61.3 percent were enrolled in bilingual education and 38.7 percent were enrolled in ESL.

The majority of students identified as LEP during school year 2011–12 were Hispanic. Statewide, there were 762,011 Hispanic students identified as LEP, representing 91 percent of the total LEP population. The majority of students participating in bilingual and ESL programs were also Hispanic, with 97.6 percent of bilingual students and 79.3 percent of ESL students being of Hispanic origin. Students of Asian heritage were the second largest group of LEP students in school year 2011–12, comprising 5.4 percent of the LEP population. Asian students were the second largest group to receive ESL services, comprising 13.2 percent of ESL students.

In school year 2011–12, there were over 120 languages represented in Texas schools. Of the total LEP population, 758,800 students, more than 90 percent, were Spanish speakers. The second most widely spoken language among LEP students was Vietnamese, which was spoken by 1.9 percent of LEP students. Other prominent languages included Arabic, Urdu, and Korean.

BILINGUAL AND ESL TEACHERS

Texas Education Code, Section 29.061, establishes the State Board for Educator Certification as the entity responsible for issuing certificates for teaching bilingual education and English as a second language. Special certifications and certification supplements are required for teachers in bilingual and ESL programs. During school year 2011–12, there were 324,001 full-time-equivalent (FTE) teachers in public schools. Of these, 17,232 teachers, or 5.3 percent, taught in a bilingual or ESL program. **Figure 3** shows the number and percent of bilingual and ESL teachers for school districts.

In school year 2008–09, the number of bilingual and ESL teachers increased approximately 5.1 percent, which corresponded with the increase in bilingual and ESL students. Since that year, however, the number of bilingual and ESL teachers has been declining while the number of students has continued to increase. **Figure 4** shows that the number of bilingual and ESL students per teacher has increased from 31 to 47 in the last four years, a 52 percent increase. During this same period, the number of all students per teacher increased from 14 to 15, a 7 percent increase.

BILINGUAL AND ESL REVENUES AND EXPENDITURES

For each student that is enrolled in a bilingual or ESL program, school districts and charter schools receive a state

FIGURE 2
LIMITED ENGLISH PROFICIENT STUDENTS ENROLLED IN BILINGUAL OR ESL PROGRAMS
SCHOOL YEARS 2008–09 TO 2011–12

MEASURE	2008–09	2009–10	2010–11	2011–12	PERCENTAGE DIFFERENCE 2008–09 TO 2011–12
Total Enrollment	4,749,571	4,847,844	4,933,617	4,998,579	5.2%
Students Identified as LEP	800,554	817,074	831,812	838,418	4.7%
Students Enrolled in a Bilingual or ESL Program	757,824	779,771	797,683	809,854	6.9%
Students Enrolled in a Bilingual Program	448,928	468,520	485,205	496,047	10.5%
Students Enrolled in an ESL Program	308,896	311,251	312,478	313,807	1.6%
Percentage of Bilingual/ESL Students in a Bilingual Program	59.2%	60.1%	60.8%	61.3%	2.1%
Percentage of Bilingual/ESL Students in an ESL Program	40.8%	39.9%	39.2%	38.7%	(2.1%)

Source: Texas Education Agency.

FIGURE 3
BILINGUAL/ESL TEACHERS BY DISTRICT SIZE
SCHOOL YEAR 2011–12

DISTRICT SIZE (ENROLLMENT)	TOTAL TEACHER FTE	BILINGUAL/ESL FTE TEACHERS	BILINGUAL/ESL TEACHERS AS PERCENTAGE OF TOTAL TEACHERS
50,000 or more	89,375	5,950	6.7%
25,000 to 49,999	68,236	4,320	6.3%
10,000 to 24,999	54,735	3,240	5.9%
5,000 to 9,999	31,146	1,731	5.6%
3,000 to 4,999	23,342	944	4.0%
1,600 to 2,999	19,529	517	2.6%
1,000 to 1,599	13,385	246	1.8%
500 to 999	14,138	204	1.4%
Less than 500	10,117	80	0.8%
State Total	**324,001**	**17,232**	**5.3%**

Note: Number for Total Teacher FTE may not add to state total due to rounding.
Source: Texas Education Agency.

FIGURE 4
BILINGUAL/ESL TEACHERS AND STUDENTS
SCHOOL YEARS 2008–09 TO 2011–12

YEAR	BILINGUAL/ESL TEACHERS	PERCENTAGE CHANGE IN BILINGUAL/ESL TEACHERS	BILINGUAL/ESL STUDENTS	PERCENTAGE CHANGE IN BILINGUAL/ESL STUDENTS	BILINGUAL/ESL STUDENTS PER TEACHER
2008–09	24,508	4.8%	757,824	5.1%	31
2009–10	23,412	(4.5%)	779,771	2.9%	33
2010–11	18,301	(21.8%)	797,683	2.3%	44
2011–12	17,232	(5.8%)	809,854	1.5%	47

Source: Texas Education Agency.

funding allotment from the Foundation School Program (FSP). To calculate the bilingual/ESL FSP allotment, the per student allotment for a district or charter is multiplied by 0.1 and then multiplied by the number of bilingual and ESL students in Average Daily Attendance (ADA). In 2010–11, the ADA for Bilingual/ESL students was 719,626 and resulted in a statewide allotment of $377 million in Tier 1 of the FSP. Additional funding for bilingual/ESL is generated through other portions of the FSP resulting in $428.2 million in total state funding. Title III of the federal No Child Left Behind Act also provides additional funds.

It is important to note that bilingual/ESL funding is in addition to the basic allotment. This funding is in acknowledgement of the potential cost differential of providing specialized instruction to bilingual/ESL students similar to gifted and talented education, and special education students served in a mainstream setting. Thus, a bilingual/ESL student generates both the basic amount of "regular student" funding as well as the additional bilingual/ESL allotment.

Statewide total expenditures for bilingual/ESL were $1.2 billion in 2010–11, which included local and federal funds. **Figure 5** shows bilingual/ESL expenditures as a percentage of instructional expenditures for school year 2010–11.

PERFORMANCE-BASED MONITORING AND INTERVENTIONS

Texas Education Code, Section 7.028, grants TEA the authority to monitor compliance with requirements applicable to a process or a program provided by a school district, campus, program, or charter. TEA monitors and evaluates the performance and effectiveness of the bilingual

FIGURE 5
BILINGUAL/ESL EXPENDITURES AS A PERCENTAGE OF INSTRUCTIONAL EXPENDITURES
SCHOOL YEAR 2010–11

DISTRICT SIZE	TOTAL OPERATING EXPENDITURES PER PUPIL	TOTAL INSTRUCTIONAL EXPENDITURES PER PUPIL	BILINGUAL/ESL AS PERCENT OF INSTRUCTIONAL EXPENDITURES
50,000 or more	$8,578	$5,292	8.0%
25,000 to 49,999	$8,390	$5,189	4.6%
10,000 to 24,999	$8,499	$5,194	2.9%
5,000 to 9,999	$8,444	$5,132	3.1%
3,000 to 4,999	$8,510	$5,190	1.9%
1,600 to 2,999	$8,794	$5,392	1.6%
1,000 to 1,599	$9,149	$5,740	1.2%
500 to 999	$10,001	$6,250	0.8%
Less than 500	$11,419	$6,971	0.7%
State Total	**$8,628**	**$5,308**	**4.5%**

Source: Texas Education Agency.

and ESL programs in public schools each year using the Performance-Based Monitoring Analysis System (PBMAS).

In accordance with TEA rules, the PBMAS evaluates bilingual and ESL programs by using student performance and program effectiveness indicators. A public school's effectiveness on each indicator is reported using corresponding performance levels. The assignment of levels is based on specific criteria and calculations. Both indicators and performance levels are established by the Commissioner of Education (commissioner). The criteria and calculations used in the PBMAS are determined each year by the commissioner and are communicated to public schools.

Figure 6 identifies the eight bilingual/ESL indicators used in the 2012 PBMAS. The results of the PBMAS are provided to public schools each year in the form of 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 zero rating indicates that a

FIGURE 6
2012 PERFORMANCE-BASED MONITORING ANALYSIS SYSTEM BILINGUAL/ESL INDICATORS

Bilingual STAAR Passing Rate at TAKS Equivalency	The percentage of bilingual students passing the State of Texas Assessments of Academic Readiness (STAAR) subject test (Mathematics, Reading, Science, Social Studies, and Writing) at the Texas Assessment of Knowledge and Skills (TAKS) equivalency performance standard.
ESL STAAR Passing Rate at TAKS Equivalency	The percentage of ESL students passing the STAAR subject test (Mathematics, Reading, Science, Social Studies, and Writing) at the TAKS equivalency performance standard.
LEP (Not Served in bilingual/ESL) STAAR Passing Rate at TAKS Equivalency	The percentage of LEP students not served in a bilingual or ESL program passing the STAAR subject test (Mathematics, Reading, Science, Social Studies, and Writing) at the TAKS equivalency performance standard.
LEP Year-After-Exit English STAAR Passing Rate at TAKS Equivalency	The percentage of certain former LEP students passing the STAAR subject test (Mathematics, Reading, Science, Social Studies, and Writing) at the TAKS equivalency performance standard in English.
TELPAS Reading Beginning Proficiency Level Rate	The percentage of LEP students tested over two years who are performing at the beginning proficiency level on the TELPAS reading test in the current year.
LEP Annual Dropout Rate (Grades 7–12)	The percentage of LEP students (Grades 7–12) who dropped out in school year 2010–11.
LEP RHSP/DAP Diploma Rate	The percentage of LEP students graduating with a Recommended High School Program (RHSP) or Distinguished Achievement Program (DAP) diploma in school year 2010–11.
LEP Graduation Rate	The percentage of LEP students who graduated with a high school diploma in four years. (Based on the number of LEP students in the grade 9 cohort who graduated by 2010–11).

Source: Texas Education Agency.

public school met the standard, while level three indicates that a public school performed significantly below the standard. On the 2012 PBMAS summary report, the Texas English Language Proficiency Assessment System (TELPAS) reading beginning proficiency level rate was not reported using a performance level. The TELPAS is used to assess a LEP student's progress in learning the English language. The beginning proficiency level rate on the reading portion of the TELPAS was included for district information and planning purposes only.

For the 2012 PBMAS report, TEA used data from both school years 2010–11 and 2011–12 to monitor public school performance. TEA used student data from school year 2011–12 to evaluate performance on indicators based on passing rates on the STAAR and the beginning proficiency level rate on the TELPAS reading exam. Because school completion data is not available until the fall, TEA used data from school year 2010–11 to assess performance on the indicators pertaining to graduation and dropout rates.

Monitoring of bilingual and ESL programs is performed in conjunction with interventions in order to promote program effectiveness and improved student performance. The Texas Administrative Code, Section 97.1071, grants the commissioner authority to use graduated stages of intervention to address student performance, program effectiveness, and/or data quality deficiencies. To make determinations regarding monitoring and interventions, TEA evaluates a public school's performance levels on the PBMAS bilingual/ESL indicators. TEA uses the results of the longitudinal performance-based monitoring data and the annual PBMAS review to determine the stage of intervention appropriate for public schools. 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. **Figure 7** shows the number of public schools receiving each stage of intervention in school year 2012–13.

Each stage of intervention involves specific activities designed to identify and address factors that contribute to below standard performance. Sanctions assigned for each stage of intervention increase in severity. **Figure 8** lists the activities required at each stage.

Materials and documents developed in the intervention process are retained locally for intervention stages one and two unless randomly selected for review by TEA. Public schools in stages three and four are required to submit documentation for all intervention activities to TEA.

For public schools in stage four, TEA also conducts a targeted intervention to address program effectiveness concerns related to substantial or ongoing risks identified in district data. After the targeted review, public schools are required to develop or revise their CIP to address the findings. TEA reviews and approves the CIP and monitors its implementation. Any public school undergoing interventions may be selected for an on-site investigation by TEA. The decision to conduct an on-site investigation is based on the identification of documented, substantial, or ongoing risks.

FIGURE 7
NUMBER OF DISTRICTS AND CHARTERS BY STAGE OF BILINGUAL/ESL INTERVENTION
SCHOOL YEAR 2012–13

	STAGE 1	STAGE 2	STAGE 3	STAGE 4	CONTINUING FOLLOW UP/CORRECTING NONCOMPLIANCE FROM PREVIOUS YEAR
Number of Districts/charters	67	39	24	10	4

Source: Texas Education Agency.

FIGURE 8
STAGES OF BILINGUAL/ESL PROGRAM INTERVENTIONS

STAGE	INTERVENTION ACTIVITIES
Stage One	• Focused Data Analysis: Work with stakeholders to gather and review data to identify possible causes for areas of low performance. • Continuous Improvement Plan: Develop a continuous improvement plan (CIP) that incorporates the results of the focused data analysis and addresses any problems that were found.
Stage Two	• Focused Data Analysis • Continuous Improvement Plan • System Analysis: Review data sets to identify overarching trends and systemic issues. The results of the system analysis must be included in the CIP.
Stage Three	• Focused Data Analysis • Continuous Improvement Plan • System Analysis • Public Program Performance Review: Feedback from stakeholders regarding the operation of the bilingual and ESL program is gathered through one or more community focus groups. The results of the review must be included in the CIP.
Stage Four	• Focused Data Analysis • Continuous Improvement Plan • System Analysis • Public Program Performance Review • Student Level Review: Conduct a student level review including both PBMAS and locally available data.

Source: Texas Education Agency.