OFFICIAL STATEMENT
Dated: July 14, 2015

Rating (PSF): S&P:.....“AAA”
(See “OTHER INFORMATION – RATINGS” herein)

NEW ISSUE - Book-Entry Only

*In the opinion of Co-Bond Counsel, based on existing law and subject to conditions described in the section herein entitled **“TAX MATTERS”** interest on the Bonds (including any accrued “original issue discount” properly allocable to the owners of such Bonds) is excludable from the gross income of the owners of the Bonds for federal income tax purposes and interest on the Bonds is not treated as a preference item for purposes of the federal alternative minimum tax imposed on individuals and corporations; provided, however, that for purposes of the alternative minimum tax on corporations, interest on the Bonds is included in computing adjusted current earnings. See **“TAX MATTERS”** herein regarding certain tax considerations.*

The District has designated the Bonds as “Qualified Tax-Exempt Obligations” for Financial Institutions.

$3,740,000
CHILLICOTHE INDEPENDENT SCHOOL DISTRICT
(Hardeman and Wilbarger Counties, Texas)
UNLIMITED TAX SCHOOL BUILDING BONDS
SERIES 2015

Dated Date: July 1, 2015 **Due: August 15 as shown on the inside cover page**

Chillicothe Independent School District (the “District”) is issuing its $3,740,000 Unlimited Tax School Building Bonds, Series 2015 (the “Bonds”). The Bonds are issued pursuant to the Constitution and general laws of the State, including particularly Chapter 45, Texas Education Code, as amended, and an election held in the District on May 9, 2015, and are direct obligations of the District. The Bonds are payable from an ad valorem tax levied, without legal limit as to rate or amount, on all taxable property located within the District, as provided in the order authorizing issuance of the Bonds (the “Order”) (see “THE BONDS – Authority for Issuance”). Additionally, the District has received conditional approval of the Bonds to be guaranteed by the Permanent School Fund of the State of Texas (see “THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM”).

Interest on the Bonds will accrue from the date of their delivery and will be payable on August 15 and February 15 of each year, commencing August 15, 2015, until maturity or prior redemption. The Bonds will be issued in principal denominations of $5,000 or any integral multiple thereof within a maturity. Interest accruing on the Bonds will be calculated on the basis of a 360-day year of twelve 30-day months (see “THE BONDS – Description of the Bonds”).

The District intends to use the Book-Entry Only System of The Depository Trust Company (“DTC”), but use of such system could be discontinued. The principal of the Bonds at maturity or on a prior redemption date and interest on the Bonds will be payable to Cede & Co., as nominee for DTC, by BOKF, NA dba Bank of Texas, Austin, Texas, as the initial Paying Agent/Registrar (the “Paying Agent/Registrar”) for the Bonds. No physical delivery of the Bonds will be made to the beneficial owners thereof. Such Book-Entry Only System will affect the method and timing of payment and the method of transfer of the Bonds (see “BOOK-ENTRY ONLY SYSTEM”).

Proceeds from the sale of the Bonds will be used (i) to finance the construction, acquisition and equipment of school buildings and (ii) to pay the costs incurred in the issuance of the Bonds. (See “THE BONDS – Purpose” and “THE BONDS – Sources and Uses of Funds”).

The Bonds maturing on and after August 15, 2026, are subject to redemption at the option of the District prior to maturity, in whole or in part, in principal amounts of $5,000 or any integral multiple thereof, on August 15, 2025, or any date thereafter, at a redemption price equal to the principal amount thereof plus accrued interest to the date fixed for redemption (see “THE BONDS – Optional Redemption”).

See Principal Amounts, Maturities, Interest Rates, and Prices on the Inside Cover Page

The Bonds are offered for delivery when, as, and if issued and received by the underwriters listed below (the “Underwriters”) and subject to the approving opinion of the Attorney General of Texas and the opinion of McGuireWoods LLP, Houston, Texas, and Powell & Leon LLP, Austin, Texas, Co-Bond Counsel (see “APPENDIX C – Form of Co-Bond Counsel’s Opinion”). Certain legal matters will be passed upon for the Underwriters by Andrews Kurth LLP, Houston, Texas, as Counsel to the Underwriters.

It is expected that the Bonds will be available for delivery through DTC on or about July 30, 2015.

RAYMOND JAMES COASTAL SECURITIES, INC.

PRINCIPAL AMOUNTS, MATURITIES, INTEREST RATES AND PRICES

$3,740,000 Unlimited Tax School Building Bonds, Series 2015

Maturity (8/15)[a]	Principal Amount	Interest Rate	Initial Reoffering Yield[b]	CUSIP No. [c] (169250)
2015	$5,000	2.000%	0.500%	CX3
2016	180,000	2.000	0.530	CF2
2017	185,000	2.000	0.980	CG0
2018	190,000	3.000	1.130	CH8
2019	195,000	3.000	1.280	CJ4
2020	205,000	3.000	1.480	CK1
2021	210,000	3.000	1.730	CL9
2022	215,000	4.000	1.980	CM7
2023	225,000	4.000	2.080	CN5
2024	230,000	4.000	2.200	CP0
2025	240,000	4.000	2.280	CQ8
2026	250,000	4.000	2.380	CR6
2027	260,000	4.000	2.480	CS4
2028	270,000	4.000	2.580	CT2
2029	280,000	4.000	2.700	CU9
2030	295,000	4.000	2.750	CV7
2031	305,000	4.000	2.800	CW5

(Interest accrues from date of delivery)

(a) The Bonds maturing on and after August 15, 2026 are subject to optional redemption, in whole or in part, on August 15, 2025, or any date thereafter, at a price equal to the par value thereof, plus accrued interest from the most recent interest payment date to the date or redemption. (See "THE BONDS – Optional Redemption").

(b) The initial yields and prices are established by, and are the sole responsibility of the Underwriters and may subsequently be changed.

(c) CUSIP numbers have been assigned to this issue by the CUSIP Global Services managed by Standard and Poor's Financial Services LLC on behalf of the American Bankers Association and are included solely for the convenience of the purchasers of the Bonds. Neither the District, the Financial Advisor, nor the Underwriters shall be responsible for the selection or correctness of the CUSIP numbers set forth herein.

USE OF INFORMATION IN THIS OFFICIAL STATEMENT

This Official Statement is not to be used in connection with an offer to sell or the solicitation of an offer to buy in any jurisdiction in which such offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so or to any person to whom it is unlawful to make such offer or solicitation.

Any information and expressions of opinion herein contained are subject to change without notice, and neither the delivery of the Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the District or other matters described herein since the date hereof. See "CONTINUING DISCLOSURE OF INFORMATION" for a description of the District's undertaking to provide certain information on a continuing basis.

THE BONDS ARE EXEMPTED FROM REGISTRATION WITH THE SECURITIES AND EXCHANGE COMMISSION AND CONSEQUENTLY HAVE NOT BEEN REGISTERED THEREWITH. THE REGISTRATION, QUALIFICATION, OR EXEMPTION OF THE BONDS IN ACCORDANCE WITH APPLICABLE SECURITIES LAW PROVISIONS OF THE JURISDICTION IN WHICH THESE SECURITIES HAVE BEEN REGISTERED OR EXEMPTED SHOULD NOT BE REGARDED AS A RECOMMENDATION THEREOF.

IN CONNECTION WITH THIS OFFERING, THE INITIAL PURCHASER MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE THE MARKET PRICE OF THE BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

Neither the District, the Underwriters, or the Financial Advisor makes any representation or warranty with respect to the information contained in this Official Statement regarding The Depository Trust Company or its Book-Entry Only System or the affairs of the Texas Education Agency described under "THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM".

The agreements of the District and others related to the Bonds are contained solely in the contracts described herein. Neither this Official Statement nor any other statement made in connection with the offer or sale of the Bonds is to be construed as constituting an agreement with the purchasers of the Bonds. INVESTORS SHOULD READ THE ENTIRE OFFICIAL STATEMENT, INCLUDING ALL SCHEDULES AND APPENDICES ATTACHED HERETO, TO OBTAIN INFORMATION ESSENTIAL TO MAKING AN INFORMED INVESTMENT DECISION.

The Underwriters have provided the following sentence for inclusion in this Official Statement. The Underwriters have reviewed the information set forth in this Official Statement in accordance with, and as part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

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FINANCIAL INFORMATION REGARDING THE DISTRICT ..... A
CHILLICOTHE INDEPENDENT SCHOOL DISTRICT ANNUAL FINANCIAL REPORT ..... B
FORM OF CO-BOND COUNSEL OPINION C

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

OFFICIAL STATEMENT SUMMARY

This summary is subject in all respects to the more complete information and definitions contained or incorporated in this Official Statement. The offering of the Bonds to potential investors is made only by means of this entire Official Statement. No person is authorized to detach this summary from this Official Statement or to otherwise use it without the entire Official Statement.

The District.....	The Chillicothe Independent School District (the "District") is a political subdivision located in Hardeman and Wilbarger Counties, Texas. The District is governed by a seven-member Board of Trustees (the "Board"), who serve staggered three-year terms with elections being held in May of each year. Policy-making and supervisory functions are the responsibility of, and are vested in, the Board. The Board delegates administrative responsibilities to the Superintendent of Schools who is the chief administrative officer of the District. Consultants and advisors supply support services. See "INTRODUCTION – Description Of The District." The District is approximately 283 square miles in area.
Authority For Issuance.....	The Bonds are issued pursuant to the Constitution and general laws of the State of Texas (the "State"), including particularly Chapter 45, Texas Education Code, as amended, an election held in the District on May 9, 2015, and the order authorizing the issuance of the Bonds passed by the Board of Trustees of the District (the "Order") (see "THE BONDS – Authority for Issuance").
The Bonds.....	The District's Unlimited Tax School Building Bonds, Series 2015 (the "Bonds") shall mature on the dates and in the amounts set forth on the inside cover page of this Official Statement (see "THE BONDS – Description of the Bonds").
Payment of Interest.....	Interest on the Bonds will accrue from the date of delivery and will be payable semiannually on August 15 and February 15 of each year, commencing August 15, 2015, until maturity or prior redemption (see "THE BONDS – Description of the Bonds").
Paying Agent/Registrar.....	The initial Paying Agent/Registrar is BOKF, NA dba Bank of Texas, Austin, Texas (see "THE BONDS – Paying Agent/Registrar"). Initially, the District intends to use the Book-Entry Only System of The Depository Trust Company (see "THE BONDS – Book-Entry Only System").
Security For The Bonds.....	The Bonds are direct obligations of the District, payable from an ad valorem tax levied, without legal limitation as to rate or amount, on all taxable property located within the District. (See "THE BONDS – Security and Source of Payment"). In addition, the District has received conditional approval for payment of the Bonds to be guaranteed by the Permanent School Fund of the State of Texas (see "THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM").
Optional Redemption.....	The Bonds maturing on and after August 15, 2026 are subject to redemption at the option of the District prior to maturity, in whole or in part, in principal amounts of $5,000 or any integral multiple thereof, on August 15, 2025 or any date thereafter, at a redemption price equal to the principal amount thereof plus accrued interest to the date fixed for redemption (see "THE BONDS – Optional Redemption").
Tax Matters.....	In the opinion of Co-Bond Counsel, interest on the Bonds is excludable from gross income for federal income tax purposes under existing law, subject to the matters described under "TAX MATTERS" herein, and is not includable in the alternative minimum taxable income of individuals. See "TAX MATTERS" for a discussion of the opinion of Co-Bond Counsel, including the alternative minimum tax on corporations. The District has designated the Bonds as qualified tax-exempt obligations. See "QUALIFIED TAX-EXEMPT OBLIGATIONS" herein.

Use of Proceeds	Proceeds from the sale of the Bonds will be used (i) to finance the construction, acquisition and equipment of school buildings and (ii) to pay the costs incurred in the issuance of the Bonds. (See "THE BONDS – Purpose" and "THE BONDS – Sources and Uses of Funds.").
Book-Entry Only System.....	The definitive Bonds will be initially registered and delivered only to Cede & Co., the nominee of DTC pursuant to the Book-Entry Only System described herein. The Bonds will be issued in principal denominations of $5,000 or any integral multiple thereof within a maturity. No physical delivery of the Bonds will be made to the beneficial owners thereof. The principal of the Bonds at maturity or on a prior redemption date and interest on the Bonds will be payable by the Paying Agent/Registrar to Cede & Co., which will make distribution of the amounts so paid to the participating members of DTC for subsequent payment to the beneficial owners of the Bonds. (See "THE BONDS – Book-Entry Only System").
Ratings.....	Standard & Poor's Ratings Services, a Standard & Poor's Financial Services LLC business ("S&P") has assigned its municipal bond rating of "AAA" to the Bonds by virtue of the guarantee of the Permanent School Fund of the State of Texas of the Bonds. An explanation of the significance of such ratings may be obtained from S&P (See "OTHER INFORMATION – Ratings").
Payment Record.....	The District has never defaulted on the payment of its bonded indebtedness.

CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

SELECTED FINANCIAL INFORMATION

Fiscal Year Ended 8/31	Estimated Population[1]	Taxable Assessed Valuation[2]	Taxable Assessed Valuation Per Capita	Tax Supported Debt Outstanding	Ratio of Tax Supported Debt to Assessed Valuation	Tax Supported Debt Per Capita
2011	1,185	$117,263,800	$ 98,957	$ 0	0.00%	$ 0
2012	1,097	113,942,710	103,868	0	0.00%	0
2013	1,262	124,859,000	98,937	0	0.00%	0
2014	1,234	240,249,554	194,692	0	0.00%	0
2015	1,280	232,124,320	181,347	3,740,000[3]	1.61%	2,922

(1) Source: The Municipal Advisory Council of Texas.
(2) As reported by the Hardeman County Appraisal District and Wilbarger County Appraisal District on the District's annual State Property Tax Reports and such values are subject to change during ensuing year.
(3) Includes the Bonds.

GENERAL FUND CONSOLIDATED STATEMENT SUMMARY

For Fiscal Year Ended August 31,

	2014	2013	2012	2011	2010
Beginning Balance	$ 1,966,310	$ 2,036,602	$ 1,971,503	$ 1,884,168	$ 2,040,709
Total Revenue	3,351,020	2,125,111	2,185,738	2,303,965	2,038,890
Total Expenditures	2,510,179	2,188,410	2,111,513	2,216,482	2,182,319
Excess/(Deficiency) of Revenues	840,841	(63,299)	74,225	87,483	(143,429)
Net Transfers/Adjustments	(16,900)	(6,993)	(9,125)	(148)	(13,112)
Ending Balance	$ 2,790,251	$ 1,966,310	$ 2,036,603	$ 1,971,503	$ 1,884,168

Source: The District's audited financial statements.

For additional information regarding the District, please contact:

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DISTRICT OFFICIALS, STAFF, AND CONSULTANTS

Elected Officials

Board of Trustees	Length of Service	Term Expires	Occupation
Mark Williams, President	23 Years	May, 2018	Highway Patrol
Mike McClellan, Vice President	15 Years	May, 2017	Farmer
Jennifer Trufan, Secretary	8 Years	May, 2018	County Extension Agent
Sharon Brock, Member	2 Years	May, 2016	Retired
Cheryl McGlocklin, Member	2 Years	May, 2016	Retired
Teresa Taylor, Member	4 Years	May, 2016	Postal Service Postmaster
Cody Crownover, Member	1 Year	May, 2017	Farmer

Selected Administrative Staff

Name	Position	Length of Service Within District	Total Industry Experience
Todd Wilson	Superintendent	1 Month	19 Years
Oralia Balderas	Business Manager	37 Years	37 Years
Patti Williams	District Secretary	10 Years	10 Years

Consultants and Advisors

Auditors ..... King, Moore, Truelove & Pharis
Vernon, Texas

Co-Bond Counsel ..... Powell & Leon, LLP, Austin, Texas
McGuireWoods LLP, Houston, Texas

Financial Advisor ..... Government Capital Securities Corporation
Southlake, Texas

OFFICIAL STATEMENT

RELATING TO
CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

$3,740,000 UNLIMITED TAX SCHOOL BUILDING BONDS, SERIES 2015

INTRODUCTION

This Official Statement, which includes APPENDICES A and B hereto, provides certain information regarding the issuance of the $3,740,000 Chillicothe Independent School District Unlimited Tax School Building Bonds, Series 2015 (the "Bonds"). Capitalized terms used in this Official Statement have the same meanings assigned to such terms in the order (the "Order") adopted by the Board of Trustees ("the Board") of the Chillicothe Independent School District (the "District") on the date of sale of the Bonds, which will authorize the issuance of the Bonds, except as otherwise indicated herein.

All financial and other information presented in this Official Statement has been provided by the District from its records, except for information expressly attributed to other sources. The presentation of information, including tables of receipts from taxes and other sources, is intended to show recent historic information and is not intended to indicate future or continuing trends in the financial position or other affairs of the District. No representation is made that past experience, as is shown by that financial and other information, will necessarily continue or be repeated in the future (see "OTHER INFORMATION – Forward Looking Statements").

Included in this Official Statement are descriptions of the Bonds, the Order, and certain other information about the District and its finances. All descriptions of documents contained herein are only summaries and are qualified in their entirety by reference to each such document. Copies of such documents may be obtained by writing the Chillicothe Independent School District, 1610 S. 6th Street, Chillicothe, Texas 79225, and, during the offering period, from the District's Financial Advisor, Government Capital Securities Corporation, 559 Silicon Drive, Suite 102, Southlake, Texas 76092, upon payment of reasonable copying, mailing, and handling charges.

This Official Statement speaks only as to its date, and the information contained herein is subject to change. Copies of the Official Statement will be deposited with the Municipal Securities Rulemaking Board, 1900 Duke Street, Suite 600, Alexandria, Virginia 22314 and will be available through its Electronic Municipal Market Access ("EMMA") System. See "CONTINUING DISCLOSURE OF INFORMATION" for a description of the District's undertaking to provide certain information on a continuing basis.

Description of the District

The District is a political subdivision of the State of Texas located in Hardeman and Wilbarger Counties, Texas. The District is governed by the Board who serve staggered three-year terms with elections being held in May of each year. Policymaking and supervisory functions are the responsibility of, and are vested in, the Board. The Board delegates administrative responsibilities to the Superintendent of Schools who is the chief administrative officer of the District. Support services are supplied by consultants and advisors. The District is approximately 283 square miles in area.

THE BONDS

Description of the Bonds

The Bonds shall be dated July 1, 2015. Interest will accrue on the Bonds from the date of delivery thereof and will be calculated on the basis of a 360-day year of twelve 30-day months. Interest on the Bonds will accrue from the date of delivery and will be payable semiannually on August 15 and February 15 of each year, commencing August 15, 2015, until maturity or prior redemption. The Bonds will be issued in principal denominations of $5,000 or any integral multiple thereof within a maturity. The paying agent and transfer agent (the "Paying Agent/Registrar") for the Bonds is initially BOKF, NA dba Bank of Texas, Austin, Texas.

Initially, the Bonds will be registered and delivered only to Cede & Co., the nominee of The Depository Trust Company ("DTC") pursuant to the Book-Entry Only System described below. No physical delivery of the Bonds will be made to the beneficial owners. The principal of the Bonds at maturity or on a prior redemption date and interest on the Bonds will be payable by the Paying Agent/Registrar to Cede & Co., which will distribute the amounts paid to the participating members of DTC for subsequent payment to the beneficial owners of the Bonds. See "THE BONDS - Book-Entry Only System" for a more complete description of such system.

Optional Redemption

The Bonds maturing on and after August 15, 2026, are subject to redemption prior to maturity, at the option of the District, in whole or in part, in principal amounts of $5,000 or any integral multiple thereof, on August 15, 2025, or any date thereafter, at a redemption price equal to the principal amount thereof plus accrued interest to the date fixed for redemption. If less than all of the Bonds are to be redeemed, the District shall determine the principal amount and maturities to be redeemed and shall direct the

Paying Agent/Registrar to select by lot or other customary method that results in a random selection, of each respective series of Bonds or portions thereof within a maturity, to be redeemed.

Notice of Redemption

At least 30 days prior to the date fixed for any such redemption, the District shall cause a written notice of such redemption to be deposited in the United States mail, postage prepaid, addressed to each registered owner at the address shown on the Registration Books of the Paying Agent/Registrar at the close of business on the business day next preceding the date of mailing such notice.

ANY NOTICE SO MAILED SHALL BE CONCLUSIVELY PRESUMED TO HAVE BEEN DULY GIVEN WHETHER OR NOT THE REGISTERED OWNER RECEIVES SUCH NOTICE. UPON THE GIVING OF THE NOTICE OF REDEMPTION AND THE DEPOSIT OF THE FUNDS NECESSARY TO REDEEM SUCH BONDS, THE BONDS CALLED FOR REDEMPTION SHALL BECOME DUE AND PAYABLE ON THE SPECIFIED REDEMPTION DATE, AND INTEREST ON SUCH BONDS OR PORTION THEREOF SHALL CEASE TO ACCRUE, IRRESPECTIVE OF WHETHER SUCH BONDS ARE SURRENDERED FOR PAYMENT.

The Paying Agent/Registrar and the District, so long as a Book-Entry Only System is used for the Bonds, will send any notice of redemption, notice of proposed amendment to the Order or other notices with respect to the Bonds only to DTC. Any failure by DTC to advise any DTC participant, or of any DTC participant or indirect participant to notify the beneficial owner, shall not affect the validity of the redemption of the Bonds called for redemption or any other action premised on any such notice. Redemption of portions of the Bonds by the District will reduce the outstanding principal amount of such Bonds held by DTC.

In such event, DTC may implement, through its Book-Entry Only System, a redemption of such Bonds held for the account of DTC participants in accordance with its rules or other agreements with DTC participants and then DTC participants and indirect participants may implement a redemption of such Bonds from the beneficial owners.

Any such selection of Bonds to be redeemed will not be governed by the Order and will not be conducted by the District or the Paying Agent/Registrar. Neither the District nor the Paying Agent/Registrar will have any responsibility to DTC participants, indirect participants, or the persons for whom DTC participants act as nominees, with respect to the payments on the Bonds or the providing of notice to DTC participants, indirect participants, or beneficial owners of the selection of portions of the Bonds for redemption (see "THE BONDS – Book-Entry Only System").

Authority For Issuance

The Bonds are being issued pursuant to authority conferred by the Constitution and general laws of the State of Texas, including particularly Chapter 45, Texas Education Code, as amended, by the Order, and by an election held in the District on May 9, 2015. Capitalized terms used herein have the same meanings assigned to such terms in the Order, except as otherwise indicated.

Purpose

Proceeds from the sale of the Bonds will be used (i) to finance the construction, acquisition and equipment of school buildings and (ii) to provide funds to pay issuance costs associated with the Bonds.

Sources and Uses of Funds

The proceeds from the sale of the Bonds will be applied approximately as follows:

Sources of Funds:	
Par Amount of the Bonds	$3,740,000.00
Plus: Net Premium	391,974.35
Total Sources of Funds	$4,131,974.35
Uses of Funds	
Deposit to Project Fund	$4,000,000.00
Underwriters' Discount, Issuance Costs and Additional Proceeds	131,974.35
Total Uses of Funds	$4,131,974.35

Security and Source of Payment

The Bonds are direct obligations of the District, payable from an ad valorem tax levied, without legal limitation as to rate or amount, on all taxable property located within the District, as provided in the Order. In addition, the District has received approval, subject to certain conditions, for the Bonds to be guaranteed by the Permanent School Fund of The State of Texas. See "THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM", "STATE AND LOCAL FUNDING OF SCHOOL DISTRICTS IN TEXAS", and "CURRENT PUBLIC SCHOOL FINANCE SYSTEM") herein.

Permanent School Fund Guarantee

In connection with the sale of the Bonds, the District has submitted an application to the Texas Education Agency for the payment of the Bonds to be guaranteed under the Guarantee Program for School District Bonds (Chapter 45, Subchapter C, of the Texas Education Code). Subject to meeting certain conditions discussed under the heading "THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM" herein, the payment of the Bonds will be guaranteed by the corpus of the Permanent School Fund of the State in accordance with the terms of the Guarantee Program for School District Bonds (the "Permanent School Fund Guarantee"). In the event of default, registered owners will receive all payments due from the corpus of the Permanent School Fund. In the event the District defeases any of the Bonds, the payment of such defeased Bonds will cease to be guaranteed by the Permanent School Fund Guarantee.

Legality

The Bonds are offered when, as, and if issued, and subject to the approval of legality by the Attorney General of the State of Texas and the opinion of McGuireWoods LLP and Powell & Leon LLP ("Co-Bond Counsel") (see "OTHER INFORMATION – Legal Matters" and "APPENDIX C – FORM OF CO-BOND COUNSEL'S OPINION").

Amendments to the Order

In the Order, the District has reserved the right to amend the Order without the consent of any holder in any manner not detrimental to the interests of the holders, including the curing of any ambiguity, inconsistency, or formal defect or omission herein. In addition, the District has reserved the right, with the consent of holders who own in the aggregate 51% of the principal amount of the Bonds then Outstanding, to amend, add to, or rescind any of the provisions of the Order; provided that, without the consent of all holders of Outstanding Bonds, no such amendment, addition, or rescission shall (i) extend the time or times of payment of the principal of and interest on the Bonds, reduce the principal amount thereof or the rate of interest thereon, or in any other way modify the terms of payment of the principal of or interest on the Bonds, (ii) give any preference to any Bond over any other Bond, or (iii) reduce the aggregate principal amount of Bonds required to be held by holders for consent to any such amendment, addition, or rescission.

Defeasance

The Order provides that the District may defease the Bonds in any manner permitted by law.

The Permanent School Fund guarantee of the Bonds will be released upon the defeasance of the Bonds.

Book-Entry Only System

This section describes how ownership of the Bonds is to be transferred and how the principal of, premium, if any, and interest on the Bonds are to be paid to and credited by The Depository Trust Company ("DTC"), New York, New York, while the Bonds are registered in its nominee name. The information in this section concerning DTC and the Book-Entry Only System has been provided by DTC for use in disclosure documents such as this Official Statement. The District, the Financial Advisor, and the Underwriters believe the source of such information to be reliable, but take no responsibility for the accuracy or completeness thereof.

The District and the Underwriters cannot and do not give any assurance that (1) DTC will distribute payments of debt service on the Bonds, or redemption or other notices, to DTC Participants, (2) DTC Participants or others will distribute debt service payments paid to DTC or its nominee (as the registered owner of the Bonds), or redemption or other notices, to the Beneficial Owners, or that they will do so on a timely basis, or (3) DTC will serve and act in the manner described in this Official Statement. The current rules applicable to DTC are on file with the United States Securities and Exchange Commission, and the current procedures of DTC to be followed in dealing with DTC Participants are on file with DTC.

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully registered Bonds in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered security certificate will be issued for the Bonds, in the aggregate principal amount of such issue, and will be deposited with DTC.

DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation, and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has a Standard & Poor's rating of "AA+". The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the Paying Agent/Registrar and request that copies of notices be provided directly to them.

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

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the District as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal, interest, and redemption payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the District or the Paying Agent/Registrar, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participant and not of DTC, the Paying Agent/Registrar, or the District, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, interest, and redemption payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the District or the Paying Agent/Registrar, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the Bonds at any time by giving reasonable notice to the District or the Paying Agent/Registrar. Under such circumstances, in the event that a successor depository is not obtained, Bonds are required to be printed and delivered.

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

Use of Certain Terms in Other Sections of this Official Statement

In reading this Official Statement it should be understood that while the Bonds are in the Book-Entry Only System, references in other sections of this Official Statement to registered owners should be read to include the person for which the Participant acquires an interest in the Bonds, but (i) all rights of ownership must be exercised through DTC and the Book-Entry Only System and (ii) except as described above, notices that are to be given to registered owners under the Bond Order will be given only to DTC.

The information in this section concerning DTC and DTC's book-entry-only system has been obtained from sources that the District believes to be reliable, but the District takes no responsibility for the accuracy thereof.

Paying Agent/Registrar

BOKF, NA dba Bank of Texas, Austin, Texas has been named to serve as initial Paying Agent/Registrar for the Bonds. In the Order, the District retains the right to replace the Paying Agent/Registrar. If the District replaces the Paying Agent/Registrar, such Paying Agent/Registrar shall, promptly upon the appointment of a successor, deliver the Paying Agent/Registrar's records to the successor Paying Agent/Registrar, and the successor Paying Agent/Registrar shall act in the same capacity as the previous Paying Agent/Registrar. Any successor Paying Agent/Registrar selected by the District shall be a commercial bank; a trust company organized under applicable law; or other entity duly qualified and legally authorized to serve and perform the duties of the Paying Agent/Registrar for the Bonds. Upon any change in the Paying Agent/Registrar for the Bonds, the District agrees to promptly cause a written notice thereof to be sent to each registered owner of the Bonds by United States mail, first class, postage prepaid, which notice shall also give the address of the new Paying Agent/Registrar.

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

Transfer, Exchange, and Registration

In the event the Book-Entry Only System should be discontinued, the Bonds may be transferred and exchanged on the registration books of the Paying Agent/Registrar only upon presentation and surrender thereof to the Paying Agent/Registrar and such transfer or exchange shall be without expense or service charge to the registered owner, except for any tax or other governmental charges required to be paid with respect to such registration, exchange and transfer. Bonds may be assigned by the

execution of an assignment form on the respective Bonds or by other instrument of transfer and assignment acceptable to the Paying Agent/Registrar. New Bonds will be delivered by the Paying Agent/Registrar, in lieu of the Bonds being transferred or exchanged, at the principal office of the Paying Agent/Registrar, or sent by United States mail, first class, postage prepaid, to the new registered owner or his designee. To the extent possible, new Bonds issued in an exchange or transfer of Bonds will be delivered to the registered owner or assignee of the registered owner in not more than three business days after the receipt of the Bonds to be canceled, and the written instrument of transfer or request for exchange duly executed by the registered owner or his duly authorized agent, in form satisfactory to the Paying Agent/Registrar. New Bonds registered and delivered in an exchange or transfer shall be in any integral multiple of $5,000 for any one maturity and for a like aggregate principal amount as the Bonds surrendered for exchange or transfer. See "THE BONDS - Book-Entry Only System" for a description of the system to be utilized initially in regard to ownership and transferability of the Bonds.

Neither the District nor the Paying Agent/Registrar shall be required to transfer or exchange Bonds (i) during a period beginning at the close of business on any Record Date and ending with the next interest payment date or (ii) with respect to any Bond or any portion thereof called for redemption prior to maturity, within 45 days prior to its redemption date provided, however, such limitation of transfer shall not be applicable to an exchange by the registered owner of the uncalled balance of a Bond.

Record Date for Interest Payment

The record date ("Record Date") for the interest payable on any interest payment date means the close of business on the last business day of the month next preceding such interest payment date.

In the event of a non-payment of interest on a scheduled payment date, and for 30 days thereafter, a new record date for such interest payment (a "Special Record Date") will be established by the Paying Agent/Registrar, if and when funds for the payment of such interest have received from the District. Notice of the Special Record Date and of the scheduled payment date of the past due interest ("Special Payment Date"), which shall be 15 days after the Special Record Date, shall be sent at least five business days prior to the Special Record Date by United States mail, first class postage prepaid, to the address of each registered owner of a Bond appearing on the registration books of the Paying Agent/Registrar at the close of business on the last business day next preceding the date of mailing of such notice.

Owners' Remedies

The Order does not provide for the appointment of a trustee to represent the interests of the Bondholders upon any failure of the District to perform in accordance with the terms of the Order or upon any other condition and, in the event of any such failure to perform, the registered owners would be responsible for the initiation and cost of any legal action to enforce performance of the Order. Furthermore, the Order does not establish specific events of default with respect to the Bonds and, under State law, there is no right to the acceleration of maturity of the Bonds upon the failure of the District to observe any covenant under the Order. A registered owner of Bonds could seek a judgment against the District if a default occurred in the payment of principal of or interest on any such Bonds; however, such judgment could not be satisfied by execution against any property of the District and a suit for monetary damages could be vulnerable to the defense of sovereign immunity. A registered owner's only practical remedy, if a default occurs, is a mandamus or mandatory injunction proceeding to compel the District to levy, assess, and collect an annual ad valorem tax sufficient to pay principal of and interest on the Bonds as it becomes due or perform other material terms and covenants contained in the Order. In general, Texas courts have held that a writ of mandamus may be issued to require a public official to perform legally imposed ministerial duties necessary for the performance of a valid contract, and Texas law provides that, following their approval by the Attorney General and issuance, the Bonds are valid and binding obligations for all purposes according to their terms. However, the enforcement of any such remedy may be difficult and time consuming and a registered owner could be required to enforce such remedy on a periodic basis. The District is also eligible to seek relief from its creditors under Chapter 9 of the U.S. Bankruptcy Code ("Chapter 9"). Although Chapter 9 provides for the recognition of a security interest represented by a specifically pledged source of revenues, the pledge of taxes in support of a general obligation of a bankrupt entity is not specifically recognized as a security interest under Chapter 9. Chapter 9 also includes an automatic stay provision that would prohibit, without Bankruptcy Court approval, the prosecution of any other legal action by creditors or Bondholders of an entity which has sought protection under Chapter 9. Therefore, should the District avail itself of Chapter 9 protection from creditors, the ability to enforce would be subject to the approval of the Bankruptcy Court (which could require that the action be heard in Bankruptcy Court instead of other federal or state court); and the Bankruptcy Code provides for broad discretionary powers of a Bankruptcy Court in administering any proceeding brought before it. The opinion of Co-Bond Counsel will note that all opinions relative to the enforceability of the Order and the Bonds are qualified with respect to the customary rights of debtors relative to their creditors, including rights afforded to creditors under the Bankruptcy Code.

THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM

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

This disclosure statement provides information relating to the program (the "Guarantee Program") administered by the Texas Education Agency (the "TEA") with respect to the Texas Permanent School Fund guarantee of tax-supported bonds issued by

Texas school districts and the guarantee of revenue bonds issued by or for the benefit of Texas charter districts. The Guarantee Program was authorized by an amendment to the Texas Constitution in 1983 and by Subchapter C of Chapter 45 of the Texas Education Code, as amended (the "Act"). While the Guarantee Program applies to bonds issued by or for both school districts and charter districts, as described below, the Act and the program rules for the two types of districts have some distinctions. For convenience of description and reference, those aspects of the Guarantee Program that are applicable to school district bonds and to charter district bonds are referred to herein as the "School District Bond Guarantee Program" and the "Charter District Bond Guarantee Program," respectively.

Some of the information contained in this Section may include projections or other forward-looking statements regarding future events or the future financial performance of the Texas Permanent School Fund (the "PSF" or the "Fund"). Actual results may differ materially from those contained in any such projections or forward-looking statements.

History and Purpose

The PSF was created with a $2,000,000 appropriation by the Texas Legislature (the "Legislature") in 1854 expressly for the benefit of the public schools of Texas. The Constitution of 1876 stipulated that certain lands and all proceeds from the sale of these lands should also constitute the PSF. Additional acts later gave more public domain land and rights to the PSF. In 1953, the U.S. Congress passed the Submerged Lands Act that relinquished to coastal states all rights of the U.S. navigable waters within state boundaries. If the state, by law, had set a larger boundary prior to or at the time of admission to the Union, or if the boundary had been approved by Congress, then the larger boundary applied. After three years of litigation (1957-1960), the U. S. Supreme Court on May 31, 1960, affirmed Texas' historic three marine leagues (10.35 miles) seaward boundary. Texas proved its submerged lands property rights to three leagues into the Gulf of Mexico by citing historic laws and treaties dating back to 1836. All lands lying within that limit belong to the PSF. The proceeds from the sale and the mineral-related rental of these lands, including bonuses, delay rentals and royalty payments, become the corpus of the Fund. Prior to the approval by the voters of the State of an amendment to the constitutional provision under which the Fund is established and administered, which occurred on September 13, 2003 (the "Total Return Constitutional Amendment"), and which is further described below, the PSF had as its main sources of revenues capital gains from securities transactions and royalties from the sale of oil and natural gas. The Total Return Constitutional Amendment provides that interest and dividends produced by Fund investments will be additional revenue to the PSF. The State School Land Board ("SLB") maintains the land endowment of the Fund on behalf of the Fund and is authorized to manage the investments of the capital gains, royalties and other investment income relating to the land endowment. The SLB is a three member board, the membership of which consists of the Commissioner of the Texas General Land Office (the "Land Commissioner") and two citizen members, one appointed by the Governor and one by the Texas Attorney General (the "Attorney General").

The Texas Constitution describes the PSF as "permanent" and "perpetual." Prior to the approval by Total Return Constitutional Amendment, only the income produced by the PSF was to be used to complement taxes in financing public education.

On November 8, 1983, the voters of the State approved a constitutional amendment that provides for the guarantee by the PSF of bonds issued by school districts. On approval by the State Commissioner of Education (the "Commissioner"), bonds properly issued by a school district are fully guaranteed by the corpus of the PSF. See "The School District Bond Guarantee Program."

In 2011, Senate Bill 1 ("SB 1") was enacted by the Legislature. Among other provisions, SB 1 established the Charter District Bond Guarantee Program as a new component of the Guarantee Program, and authorized the use of the PSF to guarantee revenue bonds issued by or for the benefit of certain open-enrollment charter schools that are designated as "charter districts" by the Commissioner. On approval by the Commissioner, bonds properly issued by a charter district participating in the Program are fully guaranteed by the corpus of the PSF. As described below, the implementation of the Charter District Bond Guarantee Program was deferred pending receipt of guidance from the Internal Revenue Service (the "IRS") which was received in September 2013, and the establishment of regulations to govern the program, which regulations were published for public comment on December 20, 2013, approved on January 30, 2014 and became effective on March 3, 2014. See "The Charter District Bond Guarantee Program."

State law also permits charter schools to be chartered and operated by school districts and other political subdivisions, but bond financing of facilities for school district-operated charter schools is subject to the School District Bond Guarantee Program, not the Charter District Bond Guarantee Program.

While the School District Bond Guarantee Program and the Charter District Bond Guarantee Program relate to different types of bonds issued for different types of Texas public schools, and have different program regulations and requirements, a bond guaranteed under either part of the Guarantee Program has the same effect with respect to the guarantee obligation of the Fund thereto, and all guaranteed bonds are aggregated for purposes of determining the capacity of the Guarantee Program (see "Capacity Limits for the Guarantee Program"). The Charter District Bond Guarantee Program as enacted by State law has not been reviewed by any court, nor has the Texas Attorney General been requested to issue an opinion, with respect to its constitutional validity.

The sole purpose of the PSF is to assist in the funding of public education for present and future generations. Prior to the adoption of the Total Return Constitutional Amendment, all interest and dividends produced by Fund investments flowed into the Available School Fund (the "ASF"), where they are distributed to local school districts and open-enrollment charter schools based on average daily attendance. Any net gains from investments of the Fund accrue to the corpus of the PSF. Prior to the approval by the voters of the State of the Total Return Constitutional Amendment, costs of administering the PSF were allocated to the ASF. With the approval of the Total Return Constitutional Amendment, the administrative costs of the Fund have shifted from the ASF to the PSF. In fiscal year 2014, distributions to the ASF amounted to $175.43 per student and the total amount distributed to the ASF was $838.67 million.

Audited financial information for the PSF is provided annually through the PSF Annual Report (the "Annual Report"), which is filed with the Municipal Securities Rulemaking Board ("MSRB"). The Annual Report includes the Message of the Executive Administrator of the Fund (the "Message") and the Management's Discussion and Analysis ("MD&A"). The Annual Report for the year ended August 31, 2014, as filed with the MSRB in accordance with the PSF undertaking and agreement made in accordance with Rule 15c2-12 ("Rule 15c2-12") of the federal Securities and Exchange Commission (the "SEC"), as described below, is hereby incorporated by reference into this disclosure. Information included herein for the year ended August 31, 2014 is derived from the audited financial statements of the PSF, which are included in the Annual Report when it is filed and posted. Reference is made to the Annual Report for the complete Message and MD&A for the year ended August 31, 2014 and for a description of the financial results of the PSF for the year ended August 31, 2014, the most recent year for which audited financial information regarding the Fund is available. The 2014 Annual Report speaks only as of its date and the TEA has not obligated itself to update the 2014 Annual Report or any other Annual Report. The TEA posts each Annual Report, which includes statistical data regarding the Fund as of the close of each fiscal year, the most recent disclosure for the Guarantee Program, the Statement of Investment Objectives, Policies and Guidelines of the Texas Permanent School Fund, which is codified at 19 Texas Administrative Code, Chapter 33 (the "Investment Policy"), monthly updates with respect to the capacity of the Guarantee Program (collectively, the "Web Site Materials") on the TEA web site at http://tea.texas.gov/Finance_and_Grants/Permanent_School_Fund/ and with the MSRB at www.emma.msrb.org. Such monthly updates regarding the Guarantee Program are also incorporated herein and made a part hereof for all purposes. In addition to the Web Site Materials, the Fund is required to make quarterly filings with the SEC under Section 13(f) of the Securities Exchange Act of 1934. Such filings, which consist of a list of the Fund's holdings of securities specified in Section 13(f), including exchange-traded (*e.g.*, NYSE) or NASDAQ-quoted stocks, equity options and warrants, shares of closed-end investment companies and certain convertible debt securities, is available from the SEC at www.sec.gov/edgar.shtml. A list of the Fund's equity and fixed income holdings as of August 31 of each year is posted to the TEA web site and filed with the MSRB. Such list excludes holdings in the Fund's securities lending program. Such list, when filed, is incorporated herein and made a part hereof for all purposes.

The Total Return Constitutional Amendment

The Total Return Constitutional Amendment approved a fundamental change in the way that distributions are made to the ASF from the PSF. The Total Return Constitutional Amendment requires that PSF distributions to the ASF be determined using a total-return-based formula instead of the current-income-based formula, which was used from 1964 to the end of the 2003 fiscal year. The Total Return Constitutional Amendment provides that the total amount distributed from the Fund to the ASF: (1) in each year of a State fiscal biennium must be an amount that is not more than 6% of the average of the market value of the Fund, excluding real property (the "Distribution Rate"), on the last day of each of the sixteen State fiscal quarters preceding the Regular Session of the Legislature that begins before that State fiscal biennium (the "Distribution Measurement Period"), in accordance with the rate adopted by: (a) a vote of two-thirds of the total membership of the State Board of Education ("SBOE"), taken before the Regular Session of the Legislature convenes or (b) the Legislature by general law or appropriation, if the SBOE does not adopt a rate as provided by clause (a); and (2) over the ten-year period consisting of the current State fiscal year and the nine preceding state fiscal years may not exceed the total return on all investment assets of the Fund over the same ten-year period (the "Ten Year Total Return"). In April 2009, the Attorney General issued a legal opinion, Op. Tex. Att'y Gen. No. GA-0707 (2009) ("GA-0707"), at the request of the Chairman of the SBOE with regard to certain matters pertaining to the Distribution Rate and the determination of the Ten Year Total Return. In GA-0707 the Attorney General opined, among other advice, that (i) the Ten Year Total Return should be calculated on an annual basis, (ii) a contingency plan adopted by the SBOE, to permit monthly transfers equal in aggregate to the annual Distribution Rate to be halted and subsequently made up if such transfers temporarily exceed the Ten Year Total Return, is not prohibited by State law, provided that such contingency plan applies only within a fiscal year time basis, not on a biennium basis, and (iii) that the amount distributed from the Fund in a fiscal year may not exceed 6% of the average of the market value of the Fund or the Ten Year Total Return. In accordance with GA-0707, in the event that the Ten Year Total Return is exceeded during a fiscal year, transfers to the ASF will be halted. However, if the Ten Year Total Return subsequently increases during that biennium, transfers may be resumed, if the SBOE has provided for that contingency, and made in full during the remaining period of the biennium, subject to the limit of 6% in any one fiscal year. Any shortfall in the transfer that results from such events from one biennium may not be paid over to the ASF in a subsequent biennium as the SBOE would make a separate payout determination for that subsequent biennium.

In determining the Distribution Rate, the SBOE has adopted the goal of maximizing the amount distributed from the Fund in a manner designed to preserve "intergenerational equity." Intergenerational equity is the maintenance of endowment purchasing

power to ensure that endowment spending keeps pace with inflation, with the ultimate goal being to ensure that current and future generations are given equal levels of purchasing power. In making this determination, the SBOE takes into account various considerations, and relies particularly upon its external investment consultant, which undertakes a probability analysis for long term projection periods that includes certain assumptions. Among the assumptions used in the analysis are a projected rate of growth of the average daily scholastic attendance State-wide, the projected contributions and expenses of the Fund, projected returns in the capital markets and a projected inflation rate.

The SBOE established the Distribution Rate from the Fund to the ASF for fiscal years 2008 and 2009 at 3.5% and for fiscal years 2010 and 2011 at 2.5% of the average of the PSF market value during the respective Distribution Measurement Periods. The decision of the SBOE regarding the Distribution Rate for 2008 through 2011 took into account a commitment by the SLB to transfer at least $100 million per year in fiscal years 2008 through 2011. The SBOE set the Distribution Rate for the 2012-13 biennium at 4.2%, which rate was determined after the SLB authorized the release of a total of $500 million to the PSF in quarterly installments during the 2012-13 biennium. In November 2012, the SBOE set the Distribution Rate for the 2014-15 biennium at 3.3%, which is expected to produce an effective rate of 3.5% taking into account the broadening of the calculation base for the Fund that was effected by a 2011 State constitutional amendment, which amendment did not increase Fund revenues. That distribution rate represents $1.68 billion in transfers to the ASF during the current biennium. In September 2014, the SBOE adopted a 3.5% Distribution Rate for 2016 - 2017, which takes into account a commitment of the SLB to transfer $175 million and $200 million to the PSF in fiscal years 2016 and 2017, respectively. See "2011 Constitutional Amendment" below for a description of amendments made to the Texas Constitution on November 8, 2011 that permit the SLB to make transfers directly to the ASF up to the amount of $300 million in each fiscal year.

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

With respect to the management of the Fund's financial assets portfolio, the single most significant change made to date as a result of the Total Return Constitutional Amendment has been new asset allocation policies adopted from time to time by the SBOE. The SBOE generally reviews the asset allocations during its summer meeting in even numbered years. The first asset allocation policy adopted by the SBOE following the Total Return Constitutional Amendment was in February 2004, and the policy was reviewed and modified or reaffirmed in the summers of 2006, 2008, 2010, 2012 and 2014. The Fund's investment policy provides for minimum and maximum ranges among the components of each of the three general asset classifications: equities, fixed income and alternative asset investments. The 2004 asset allocation policy decreased the fixed income target from 45% to 25% of Fund investment assets and increased the allocation for equities from 55% to 75% of investment assets. In July 2006, the SBOE modified its asset allocation to reduce the equity allocation, including both domestic and foreign equity portfolios, to a target of 53% of Fund assets, further reduced the fixed income allocation target to 19% and added an alternative asset allocation, which included real estate, real return, absolute return and private equity components, totaling 28% of the Fund's asset target. Alternative asset classes diversify the SBOE-managed assets and are not as correlated to traditional asset classes, which is intended to increase investment returns over the long run while reducing risk and return volatility of the portfolio. In July 2010, the SBOE decreased the equity allocation to 50%, and the fixed income allocation to 15%, while increasing the alternative asset allocation (which may include equity and fixed income investments as part of a variety of alternative investment strategies) to 35%. In July 2012, the SBOE modified the asset allocation policy by decreasing the equity allocation to 46%, increasing the fixed income allocation to 17%, and increasing the alternative asset allocation (which may include equity and fixed income investments as part of a variety of alternative investment strategies) to 37%. The changes made to the asset allocation in 2012 decreased the target for large cap equity investments from 21% to 18%, replaced a 4% allocation for international small cap equities with a 3% allocation for emerging international equities, reduced core fixed income bond investments from 15% to 12% and added a new 5% allocation for emerging market debt in the fixed income portfolio. The 2014 changes (i) decreased the equity allocation to 40% (by decreasing the target for large cap equities from 18% to 16%, the target for small/mid cap equities from 7% to 5% and the target for emerging and international large cap equities from 18% to 16%), (ii) increased the fixed income allocation from 17% to 19% (by increasing the 5% allocation for emerging market debt to 7%) and (iii) increased the alternative asset allocation from 37% to 41%, which included an increase in the private equity allocation of alternative assets from 6% to 10%.

For a variety of reasons, each change in asset allocation for the Fund, including the 2014 modifications, have been, and are being, implemented in phases. At August 31, 2014, the Fund's financial assets portfolio was invested as follows: 48.03% in public market equity investments; 14.95% in fixed income investments; 9.99% in absolute return assets; 3.48% in private equity assets; 4.14% in real estate assets; 6.73% in risk parity assets; 5.64% in real return assets; 6.91% in emerging market debt; and 0.13% in cash.

In July 2012 and April 2013, the SBOE also realigned the management of certain of the investment portfolios within the absolute return allocation of the alternative investments and its private equity asset class. These alignments in investment portfolios have created strategic relationships between the external manager and investment staff of the PSF, which has reduced administrative costs with respect to those portfolios. In response to a legal opinion request made by the Chair of the SBOE in October 2012, the

Attorney General has advised the SBOE in Op. Tex. Att'y Gen. No. GA-0998 (2013) ("GA-0998"), that the PSF is not subject to requirements of certain State competitive bidding laws with respect to the selection of investments. In GA-0998, the Attorney General also advised that the SBOE generally must use competitive bidding for the selection of investment managers and other third party providers of investment services, such as record keeping and insurance, but excluding certain professional services, such as accounting services, as State law prohibits the use of competitive bidding for specified professional services. GA-0998 provides guidance to the SBOE in connection with the direct management of alternative investments through investment vehicles to be created by the SBOE, in lieu of contracting with external managers for such services, as has been the recent practice of the PSF. The PSF staff and the Fund's investment advisor are tasked with advising the SBOE with respect to the implementation of the 2010 Asset Allocation Policy, including the timing and manner of the selection of any external managers and other consultants.

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

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

Management and Administration of the Fund

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

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

Texas law assigns control of the Fund's land and mineral rights to the three-member SLB, which consists of the elected Commissioner of the General Land Office ("GLO"), an appointee of the Governor, and an appointee of the Attorney General. Administrative duties related to the land and mineral rights reside with the GLO, which is under the guidance of the Commissioner of the GLO. In 2007, the Legislature established the real estate special fund account of the PSF (the "Real Estate Account") consisting of proceeds and revenue from land, mineral or royalty interest, real estate investment, or other interest, including revenue received from those sources, that is set apart to the PSF under the Texas Constitution and laws, together with the mineral estate in riverbeds, channels, and the tidelands, including islands. The investment of the Real Estate Account is subject to the sole and exclusive management and control of the SLB and the Land Commissioner, who is also the head of the GLO. The 2007 legislation presented constitutional questions regarding the respective roles of the SBOE and the SLB relating to the disposition of proceeds of real estate transactions to the ASF, among other questions. Amounts in the investment portfolio of the PSF are taken into account by the SBOE for purposes of determining the Distribution Rate. An amendment to the Texas

Constitution was approved by State voters on November 8, 2011, which permits the SLB to make transfers directly to the ASF, see "2011 Constitutional Amendment" below.

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

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

Capacity Limits for the Guarantee Program

The capacity of the Fund to guarantee bonds under the Guarantee Program is limited in two ways: by State law (the "State Capacity Limit") and by regulations and a notice issued by the IRS (the "IRS Limit"). Prior to May 20, 2003, the State Capacity Limit was equal to two times the lower of cost or fair market value of the Fund's assets, exclusive of real estate. During the 78th Regular Session of the Legislature in 2003, legislation was enacted that increased the State Capacity Limit by 25%, to two and one half times the lower of cost or fair market value of the Fund's assets as estimated by the SBOE and certified by the State Auditor, and eliminated the real estate exclusion from the calculation. Prior to the issuance of the IRS Notice (defined below), the capacity of the program under the IRS Limit was limited to two and one-half times the lower of cost or fair market value of the Fund's assets adjusted by a factor that excluded additions to the Fund made since May 14, 1989. During the 2007 Texas Legislature, Senate Bill 389 ("SB 389") was enacted providing for additional increases in the capacity of the Guarantee Program, and specifically providing that the SBOE may by rule increase the capacity of the Guarantee Program from two and one-half times the cost value of the PSF to an amount not to exceed five times the cost value of the PSF, provided that the increased limit does not violate federal law and regulations and does not prevent bonds guaranteed by the Guarantee Program from receiving the highest available credit rating, as determined by the SBOE. SB 389 further provides that the SBOE shall at least annually consider whether to change the capacity of the Guarantee Program. Since 2005, the Guarantee Program has twice reached capacity under the IRS Limit, and in each instance the Guarantee Program was closed to new bond guarantee applications until relief was obtained from the IRS. The most recent closure of the Guarantee Program commenced in March 2009 and the Guarantee Program reopened in February 2010 on the basis of receipt of the IRS Notice.

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

On September 16, 2013, the IRS published proposed regulations (the "Proposed IRS Regulations") that, among other things, would enact the IRS Notice. The preamble to the Proposed IRS Regulations provides that issuers may elect to apply the Proposed IRS Regulations, in whole or in part, to bonds sold on or after September 16, 2013, and before the date that final regulations become effective.

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

PSF staff have been tasked with undertaking due diligence with the rating agencies that currently rate the Bond Guarantee Program (see "Ratings of Bonds Guaranteed Under the Guarantee Program" below) regarding ratings maintenance for the Fund in anticipation of consideration by the SBOE of an amendment to the SDBGP Rules and CDBGP Rules (as defined below) to provide for an increase in the multiplier that establishes the State law capacity limitation. Such an amendment may be considered at meetings to be held in July and September 2015 (two readings of the amended SDBGP Rules and CDBGP Rules would be required to effect the change in the multiplier, if any is made).

Since July 1991, when the SBOE amended the Guarantee Program Rules to broaden the range of bonds that are eligible for guarantee under the Guarantee Program to encompass most Texas school district bonds, the principal amount of bonds guaranteed under the Guarantee Program has increased sharply. In addition, in recent years a number of factors have caused an increase in the amount of bonds issued by school districts in the State. See the table "Permanent School Fund Guaranteed Bonds" below. Effective September 1, 2009, the Act provides that the SBOE may annually establish a percentage of the cost value of the Fund to be reserved from use in guaranteeing bonds. The capacity of the Guarantee Program in excess of any reserved portion is referred to herein as the "Capacity Reserve." The SDBGP Rules provide for a minimum Capacity Reserve for the Guarantee Program of no less than 5%, and provide that the amount of the Capacity Reserve may be increased by a majority vote of the SBOE. The Commissioner is authorized to change the Capacity Reserve, which decision must be ratified or rejected by the SBOE at its next meeting following any change made by the Commissioner. The current Capacity Reserve is noted in the monthly updates with respect to the capacity of the Guarantee Program on the TEA web site at http://tea.texas.gov/Finance_and_Grants/Permanent_School_Fund/, which are also filed with the MSRB.

Based upon historical performance of the Fund, the legal restrictions relating to the amount of bonds that may be guaranteed has generally resulted in a lower ratio of guaranteed bonds to available assets as compared to many other types of credit enhancements that may be available for Texas school district bonds and charter district bonds. However, changes in the value of the Fund due to changes in securities markets, investment objectives of the Fund, an increase in bond issues by school districts in the State or legal restrictions on the Fund, the implementation of the Charter District Bond Guarantee Program, or an increase in the calculation base of the Fund for purposes of making transfers to the ASF, among other factors, could adversely affect the ratio of Fund assets to guaranteed bonds and the growth of the Fund in general. It is anticipated that the issuance of the IRS Notice and the Proposed IRS Regulations will likely result in a substantial increase in the amount of bonds guaranteed under the Guarantee Program. The implementation of the Charter School Bond Guarantee Program is also expected to increase the amount of guaranteed bonds.

The Act requires that the Commissioner prepare, and the SBOE approve, an annual report on the status of the Guarantee Program (the Annual Report). The State Auditor audits the financial statements of the PSF, which are separate from other State financial statements.

The School District Bond Guarantee Program

The School District Bond Guarantee Program requires an application be made by a school district to the Commissioner for a guarantee of its bonds. If the conditions for the School District Bond Guarantee Program are satisfied, the guarantee becomes effective upon approval of the bonds by the Attorney General and remains in effect until the guaranteed bonds are paid or defeased, by a refunding or otherwise.

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

If a school district fails to pay principal or interest on a bond as it is stated to mature, other amounts not due and payable are not accelerated and do not become due and payable by virtue of the district's default. The School District Bond Guarantee Program does not apply to the payment of principal and interest upon redemption of bonds, except upon mandatory sinking fund redemption, and does not apply to the obligation, if any, of a school district to pay a redemption premium on its guaranteed bonds. The guarantee applies to all matured interest on guaranteed school district bonds, whether the bonds were issued with a fixed or variable interest rate and whether the interest rate changes as a result of an interest reset provision or other bond order provision requiring an interest rate change. The guarantee does not extend to any obligation of a school district under any agreement with a third party relating to guaranteed bonds that is defined or described in State law as a "bond enhancement agreement" or a "credit agreement," unless the right to payment of such third party is directly as a result of such third party being a bondholder.

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

The SBOE has approved and modified the SDBGP Rules in recent years, most recently in May 2010. Generally, the SDBGP Rules limit guarantees to certain types of notes and bonds, including, with respect to refunding bonds issued by school districts, a requirement that the bonds produce debt service savings, and that bonds issued for capital facilities of school districts must have been voted as unlimited tax debt of the issuing district. The Guarantee Program Rules include certain accreditation criteria for districts applying for a guarantee of their bonds, and limit guarantees to districts that have less than the amount of annual debt service per average daily attendance that represents the 90th percentile of annual debt service per average daily attendance for all school districts, but such limitation will not apply to school districts that have enrollment growth of at least 25% over the previous five school years. The SDBGP Rules are codified in the Texas Administrative Code at 19 TAC section 33.65, and are available at http://ritter.tea.state.tx.us/rules/tac/chapter033/ch033a.html#33.65.

Charter District Bond Guarantee Program

The Charter District Bond Guarantee Program became effective March 3, 2014. The SBOE published final regulations in the Texas Register that provide for the administration of the Charter District Bond Guarantee Program (the "CDBGP Rules"). The CDBGP Rules are codified at 19 TAC section 33.67, and are available at http://ritter.tea.state.tx.us/rules/tac/chapter033/ch033a.html#33.67.

The Charter District Bond Guarantee Program has been authorized through the enactment of amendments to the Act, which provide that a charter holder may make application to the Commissioner for designation as a "charter district" and for a guarantee by the PSF under the Act of bonds issued on behalf of a charter district by a non-profit corporation. If the conditions for the Charter District Bond Guarantee Program are satisfied, the guarantee becomes effective upon approval of the bonds by the Attorney General and remains in effect until the guaranteed bonds are paid or defeased, by a refunding or otherwise.

Subject to clarifying advice that the TEA anticipates may be received from the Attorney General in accordance with the opinion request described below, the capacity of the Charter District Bond Guarantee Program is limited to the amount that equals the result of the percentage of the number of students enrolled in open-enrollment charter schools in the State compared to the total number of students enrolled in all public schools in the State multiplied by the available capacity of the Guarantee Program. Available capacity is defined as the maximum amount under SBOE rules, less Capacity Reserve and minus existing guarantees. The CDBGP Rules authorize the Commissioner to determine that ratio based on information provided to the TEA by school districts and open-enrollment charter schools, and the calculation will be made annually, on or about March 1 of each year. As of May 2015 (the most recent date for which data is available), the percentage of students enrolled in open-enrollment charter schools (excluding charter schools authorized by school districts) to the total State scholastic census was approximately 4.36%. As of February, 2015, there were 195 active open-enrollment charter schools in the State, and there were 659 charter school campuses operating under such charters. Section 12.101, Texas Education Code, as amended by the Legislature in 2013, provides that the Commissioner may grant not more than 215 charters through the end of fiscal year 2014, with the number increasing in each fiscal year thereafter through 2019 to a total number of 305 charters permitted by the statute. While legislation limits the number of charters that may be granted, it does not limit the number of campuses that may operate under a particular charter. For information regarding the capacity of the Guarantee Program, see "Capacity Limits for the Guarantee Program." The Act provides that the Commissioner may not approve the guarantee of refunding or refinanced bonds under the Charter District Bond Guarantee Program in a total amount that exceeds one-half of the total amount available for the guarantee of charter district bonds under the Charter District Bond Guarantee Program.

On February 27, 2015, the Attorney General issued an opinion (Op. Tex. Att'y Gen. No. KP-0005 (2015)) in response to a request by the Commissioner for clarification of Section 45.0532, Texas Education Code ("Section 45.0532"), which defines how the capacity of the Charter District Bond Guarantee Program should be calculated. In the opinion, the Attorney General ruled that the proper method for determining charter district capacity is a limitation on the total amount of charter district bonds that the Commissioner may approve for guarantee in the cumulative amount. The opinion rejected an alternative reading of the statute that would have imposed a limitation on the total amount of charter district bonds that the Commissioner may approve each

month, but not a cumulative limitation, and which, over time, could produce Charter District Bond Guarantee Program guarantees potentially exceeding the charter student ratio limitation in Section 45.0532.

In accordance with the Act, the Commissioner may not approve charter district bonds for guarantee if such guarantees will result in lower bond ratings for public school district bonds that are guaranteed under the School District Bond Guarantee Program. To be eligible for a guarantee, the Act provides that a charter district's bonds must be approved by the Attorney General, have an unenhanced investment grade rating from a nationally recognized investment rating firm, and satisfy a limited investigation conducted by the TEA.

With respect to the Charter District Bond Guarantee Program, the Act establishes a bond guarantee reserve fund in the State treasury (the "Charter District Reserve Fund"). Each charter district that has a bond guaranteed must annually remit to the Commissioner, for deposit in the Charter District Reserve Fund, an amount equal to 10% (or such higher amount as may be determined by the Commissioner) of the savings to the charter district that result from the lower interest rate on the bond due to the guarantee by the PSF. The Commissioner has approved a rule governing the calculation and payment of savings into the Charter District Reserve Fund. That rule has been codified at 19 TAC 33.1001, and is available at http://ritter.tea.state.tx.us/rules/tac/chapter033/ch033aa.html#33.1001.

The Charter District Bond Guarantee Program does not apply to the payment of principal and interest upon redemption of bonds, except upon mandatory sinking fund redemption, and does not apply to the obligation, if any, of a charter district to pay a redemption premium on its guaranteed bonds. The guarantee applies to all matured interest on guaranteed charter district bonds, whether the bonds were issued with a fixed or variable interest rate and whether the interest rate changes as a result of an interest reset provision or other bond resolution provision requiring an interest rate change. The guarantee does not extend to any obligation of a charter district under any agreement with a third party relating to guaranteed bonds that is defined or described in State law as a "bond enhancement agreement" or a "credit agreement," unless the right to payment of such third party is directly as a result of such third party being a bondholder.

The Act provides that immediately following receipt of notice that a charter district will be or is unable to pay maturing or matured principal or interest on a guaranteed bond, the Commissioner is required to instruct the Comptroller to transfer from the Charter District Reserve Fund to the district's paying agent an amount necessary to pay the maturing or matured principal or interest. If money in the Charter District Reserve Fund is insufficient to pay the amount due on a bond for which a notice of default has been received, the Commissioner is required to instruct the Comptroller to transfer from the PSF to the district's paying agent the amount necessary to pay the balance of the unpaid maturing or matured principal or interest. If a total of two or more payments are made under the Charter District Bond Guarantee Program on charter district bonds and the Commissioner determines that the charter district is acting in bad faith under the program, the Commissioner may request the Attorney General to institute appropriate legal action to compel the charter district and its officers, agents, and employees to comply with the duties required of them by law in regard to the guaranteed bonds. As is the case with the School District Bond Guarantee Program, the Act obligates the Commissioner to instruct the Comptroller to withhold the amount paid with respect to the Charter District Bond Guarantee Program, plus interest, from the first State money payable to a charter district that fails to make a guaranteed payment on its bonds. The amount withheld will be deposited, first, to the credit of the PSF, and then to restore any amount drawn from the Charter District Reserve Fund as a result of the non-payment.

The CDBGP Rules provide that the PSF may be used to guarantee bonds issued for the acquisition, construction, repair, or renovation of an educational facility for an open-enrollment charter holder and equipping real property of an open-enrollment charter school and/or to refinance promissory notes executed by an open-enrollment charter school, each in an amount in excess of $500,000 the proceeds of which loans were used for a purposes described above (so-called new money bonds) or for refinancing bonds previously issued for the charter school that were approved by the attorney general (so-called refunding bonds). Refunding bonds may not be guaranteed under the Charter District Bond Guarantee Program if they do not result in a present value savings to the charter holder.

The CDBGP Rules provide that an open-enrollment charter holder applying for charter district designation and a guarantee of its bonds under the Charter District Bond Guarantee Program satisfy various provisions of the regulations, including the following: It must (i) have operated at least one open-enrollment charter school with enrolled students in the State for at least three years; (ii) agree that the bonded indebtedness for which the guarantee is sought will be undertaken as an obligation of all entities under common control of the open-enrollment charter holder, and that all such entities will be liable for the obligation if the open-enrollment charter holder defaults on the bonded indebtedness, provided, however, that an entity that does not operate a charter school in Texas is subject to this provision only to the extent it has received state funds from the open-enrollment charter holder; (iii) have had completed for the past three years an audit for each such year that included unqualified or unmodified audit opinions; and (iv) have received an investment grade credit rating within the last year. Upon receipt of an application for guarantee under the Charter District Bond Guarantee Program, the Commissioner is required to conduct an investigation into the financial status of the applicant charter district and of the accreditation status of all open-enrollment charter schools operated under the charter, within the scope set forth in the CDBGP Rules. Such financial investigation must establish that an applying charter district has a historical debt service coverage ratio, based on annual debt service, of at least 1.1 for the most recently completed fiscal year, and a projected debt service coverage ratio, based on projected revenues and expenses and maximum annual debt service, of at least 1.2. The failure of an open-enrollment charter holder to comply with the Act or the applicable

regulations, including by making any material misrepresentations in the charter holder's application for charter district designation or guarantee under the Charter District Bond Guarantee Program, constitutes a material violation of the open-enrollment charter holder's charter.

Ratings of Bonds Guaranteed Under the Guarantee Program

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

Valuation of the PSF and Guaranteed Bonds

Permanent School Fund Valuations

Fiscal Year Ended 8/31	Book Value[(1)]	Market Value[(1)]
2010	$23,653,185,489	$27,066,200,259
2011	24,701,156,685	29,643,439,794
2012	25,161,994,845	31,284,851,266
2013	25,596,193,826	33,131,028,540
2014	27,592,932,952 [(2)]	38,441,759,636 [(2)]

[(1)] SLB managed assets are included in the market value and book value of the Fund. In determining the market value of the PSF from time to time during a fiscal year, the TEA uses current, unaudited values for TEA managed investment portfolios and cash held by the SLB. With respect to SLB managed assets shown in the table above, market values of land and mineral interests, internally managed real estate, investments in externally managed real estate funds and cash are based upon information reported to the PSF by the SLB. Beginning in fiscal year 2009, the SLB reported that information to the PSF on a quarterly basis. The valuation of such assets at any point in time is dependent upon a variety of factors, including economic conditions in the State and nation in general, and the values of these assets, and, in particular, the valuation of mineral holdings administered by the SLB, can be volatile and subject to material changes from period to period. At August 31, 2014, land, mineral assets, internally managed discretionary real estate, external discretionary real estate investments and cash managed by the SLB had unaudited book values of approximately $47.3 million, $13.4 million, $307.0 million, $1.8 billion and $2.0 billion, respectively, and unaudited market values of approximately $372.5 million, $3.3 billion, $291.1 million, $1.8 billion and $2.0 billion, respectively.
[(2)] At April 30, 2015 the PSF had a book value of $28,474,932,664 and a market value of $38,788,935,540 (April 30, 2015 values are based on unaudited data).

Permanent School Fund Guaranteed Bonds

At 8/31	Principal Amount[(1)]
2010	$ 49,301,683,338
2011	52,653,930,546
2012	53,634,455,141
2013	55,218,889,156
2014	58,364,350,783[(2)]

[(1)] Represents original principal amount; does not reflect any subsequent accretions in value for compound interest bonds (zero coupon securities). The amount shown excludes bonds that have been refunded and released from the Guarantee Program. The TEA does not maintain records of the accreted value of capital appreciation bonds that are guaranteed under the Guarantee Program.
[(2)] As of August 31, 2014, the TEA expected that the principal and interest to be paid by school districts over the remaining life of the bonds guaranteed by the Guarantee Program is $96,019,918,371, of which $37,655,567,587 represents interest to be paid. At April 30, 2015, there were $60,693,832,494 of bonds guaranteed under the Guarantee Program and the capacity of the Guarantee Program was $85,424,797,992 based on the three times cost value multiplier approved by the SBOE on May 21, 2010. Such capacity figures include the Reserve Capacity.

Permanent School Fund Guaranteed Bonds by Category[1]

	School District Bonds		Charter District Bonds		Totals	
At 8/31	Number of Issues	Principal Amount Guaranteed	Number of Issues	Principal Amount Guaranteed	Number of Issues	Principal Amount Guaranteed
2014[2]	2,869	$58,061,805,783	10	$302,545,000	2,879	$58,364,350,783

[1] Represents original principal amount; does not reflect any subsequent accretions in value for compound interest bonds (zero coupon securities). The amount shown excludes bonds that have been refunded and released from the Guarantee Program.
[2] Fiscal 2014 was the first year of operation of the Charter District Bond Guarantee Program. At April 30, 2015 (based upon unaudited data), there were $60,693,832,494 of bonds guaranteed under the Guarantee Program, representing 2,982 school district issues, aggregating $60,237,979,494 in principal amount and 17 charter district issues, aggregating $455,853,000 in principal amount. At April 30, 2015, the capacity of the Charter District Bond Guarantee Program was $892,044,036.

Discussion and Analysis Pertaining to Fiscal Year Ended August 31, 2014

The following discussion is derived from the Annual Report for the year ended August 31, 2014, including the Message of the Executive Administrator of the Fund and the Management's Discussion and Analysis contained therein. Reference is made to the Annual Report, when filed, for the complete Message and MD&A. Investment assets managed by the fifteen member SBOE are referred to throughout this MD&A as the PSF(SBOE) assets. As of August 31, 2014, the Fund's land, mineral rights and certain real assets are managed by the three-member SLB and these assets are referred to throughout as the PSF(SLB) assets. The 2014 SBOE Asset Allocation Policy includes an allocation for real estate investments, and as such investments are made, and become a part of the PSF investment portfolio, those investments will be managed by the SBOE and not the SLB.

At the end of fiscal 2014, the total Fund balance was $34.96 billion. Fund balance increased $4.35 billion from the prior year, primarily attributable to the increase in the fair value of the PSF(SBOE) equities and alternative investments, the PSF(SLB) real assets investments and the continued recovery of invested markets. During the year, the SBOE continued implementing its revised long term strategic asset allocation to diversify and strengthen the PSF(SBOE) investment assets of the Fund. The revised allocation is projected to increase returns over the long run while reducing risk and return volatility of the portfolio. The one year, three year, five year and ten year annualized total returns for the PSF(SBOE) assets were 15.94%, 11.81%, 11.30% and 7.77% respectively (total return takes into consideration the change in the market value of the Fund during the year as well as the interest and dividend income generated by the Fund's investments). In addition, the SLB continued its shift into externally managed real asset investment funds and the one year, three year, and five year annualized total returns for the PSF(SLB) real assets, including cash, were 9.73%, 9.67%, and 7.00% respectively.

The market value of the Fund's assets is directly impacted by the performance of the various financial markets in which the assets are invested. The most important factors affecting investment performance are the asset allocation decisions made by the SBOE and SLB. The current SBOE long term asset allocation policy allows for diversification of the PSF(SBOE) portfolio into alternative asset classes whose returns are not as correlated to traditional asset classes. The implementation of the long term asset allocation will occur over several fiscal years and is expected to provide incremental total return at reduced risk. As of August 31, 2014, the PSF(SBOE) portion of the Fund had diversified into emerging market large cap international equities, absolute return funds, real estate, private equity, risk parity, real return Treasury Inflation-Protected Securities, real return commodities, and emerging market debt. Emerging international equities securities will be strategically added commensurate with the economic environment and the goals and objectives of the SBOE. As of August 31, 2014, the SBOE had approved and the PSF(SBOE) made capital commitments to real estate investments in the amount of $1.58 billion and capital commitments to four private equity limited partnerships in the total amount of $2.23 billion. Unfunded commitments at August 31, 2014 were $519.6 million in real estate and $1.27 billion in private equity.

The PSF(SLB) portfolio is generally characterized by three broad categories: (1) discretionary real assets investments, (2) sovereign and other lands, and (3) mineral interests. Discretionary real assets investments consist of externally managed real estate, infrastructure, and energy/minerals investment funds; internally managed direct real estate investments, and cash. Sovereign and other lands consist primarily of the lands set aside to the PSF when it was created. Mineral interests consist of all of the minerals that are associated with PSF lands. The investment focus of PSF(SLB) discretionary real assets investments has shifted from internally managed direct real estate investments to externally managed real assets investment funds. The PSF(SLB) makes investments in certain limited partnerships that legally commit it to possible future capital contributions. At August 31, 2014, the remaining commitments totaled approximately $1.37 billion.

The PSF(SBOE)'s investment in public equity securities experienced a return of 22.2% during the fiscal year ended August 31, 2014. The PSF(SBOE)'s investment in fixed income securities produced a return of 5.9% during the fiscal year and absolute return investments yielded a return of 9.9%. The PSF(SBOE) real estate and private equity investments returned 12.3% and 22.5%, respectively. Risk parity assets produced a return of 18.1%, while real return assets yielded 2.5%. The emerging market debt asset class initiated during the year yielded a 3.5% return since inception. Combined, all PSF(SBOE) asset classes produced an investment return of 15.94% for the fiscal year ended August 31, 2014, overperforming the target index by approximately 57 basis points. All PSF(SLB) real assets (including cash) returned 9.73% for the fiscal year ending August 31, 2014.

For fiscal year 2014, total revenues, inclusive of unrealized gains and losses and net of security lending rebates and fees, totaled $5.2 billion, an increase of $2.1 billion from fiscal year 2013 earnings of $3.2 billion. This increase reflects the performance of the securities markets in which the Fund was invested in fiscal year 2014. In fiscal year 2014, revenues earned by the Fund included lease payments, bonuses and royalty income received from oil, gas and mineral leases; lease payments from commercial real estate; surface lease and easement revenues; revenues from the resale of natural and liquid gas supplies; dividends, interest, and securities lending revenues; the net change in the fair value of the investment portfolio; and, other miscellaneous fees and income.

Expenditures are paid from the Fund before distributions are made under the total return formula. Such expenditures include the costs incurred by the SLB to manage the land endowment, as well as operational costs of the Fund, including external management fees paid from appropriated funds. Total operating expenditures, net of security lending rebates and fees, increased 12.2% for the fiscal year ending August 31, 2014. This increase is primarily attributable to the operational costs related to managing alternative investments due to diversification of the Fund.

The Fund supports the public school system in the State by distributing a predetermined percentage of its asset value to the ASF. For fiscal years 2013 and 2014, the distribution from the SBOE to the ASF totaled $1.021 billion and $838.7 million, respectively. Additionally, the SLB provided $300 million to the ASF in fiscal year 2013.

At the end of the 2014 fiscal year, PSF assets guaranteed $58.364 billion in bonds issued by 821 local school districts and charter districts, the latter of which entered into the Program during the 2014 fiscal year. Since its inception in 1983, the Fund has guaranteed 5,603 school district and charter district bond issues totaling $120.7 billion in principal amount. During the 2014 fiscal year, the number of outstanding issues guaranteed under the Guarantee Program increased by 90, or 3.2%. The dollar amount of guaranteed school and charter bond issues outstanding increased by $3.15 billion or 5.7%. The guarantee capacity of the Fund increased by $1.85 billion, or 2.4%, during fiscal year 2014 due to the investment performance of the Fund.

2011 Constitutional Amendment

During the Regular Session of the 82nd Legislature, which concluded May 30, 2011, a joint resolution ("HJR 109") was enacted proposing amendments to various sections of the Texas Constitution that pertain to the PSF. In accordance with HJR 109, a referendum was held in the State on November 8, 2011. At that referendum, voters of State approved non-substantive changes to the Texas Constitution to clarify references to the Fund, and, in addition, approved an amendment that effects an increase to the base amount used in calculating the Distribution Rate from the Fund to the ASF. The amendments approved at the referendum include an increase to the base used to calculate the Distribution Rate by adding to the calculation base certain discretionary real assets and cash in the Fund that is managed by entities other than the SBOE (at present, by the SLB). The value of those assets were already included in the value of the Fund for purposes of the Guarantee Program, but prior to the amendment had not been included in the calculation base for purposes of making transfers from the Fund to the ASF. While the amendment provides for an increase in the base for the calculation of approximately $2 billion, no new resources were provided for deposit to the Fund. As described under "The Total Return Constitutional Amendment" the SBOE is prevented from approving a Distribution Rate or making a pay out from the Fund if the amount distributed would exceed 6% of the average of the market value of the Fund, excluding real property in the Fund, but including discretionary real asset investments on the last day of each of the sixteen State fiscal quarters preceding the Regular Session of the Legislature that begins before that State fiscal biennium or if such pay out would exceed the Ten Year Total Return. The new calculation base is required to be used to determine all payments to the ASF from the Fund beginning with the 2012-13 biennium. As described under "The Total Return Constitutional Amendment" the SBOE approved a Distribution Rate of 4.2% in January 2011 based on a commitment of the SLB to transfer $500 million to the PSF during the biennium. In November 2012, the SBOE established a 3.3% Distribution Rate for the 2014-15 biennium.

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

The impact of the increase in the base against which the Distribution Rate is applied will be an increase in the distributions from the PSF to the ASF, provided that there are no reductions in the percentage established biennially by the SBOE to be the Distribution Rate. For the 2012-13 biennium, the Distribution Rate has been set by the SBOE at 4.2%. Given the increase in the calculation base effected by the November 8, 2011 constitutional amendment, the effect on transfers made by the SBOE in 2012-13 will be an increase in the total return distribution by an estimated $73.7 million in each year of the biennium. Going forward, it may be necessary for the SBOE to reduce the Distribution Rate in order to preserve the corpus of the Fund in accordance with its management objective of preserving intergenerational equity, and the Distribution Rate for the 2014-15 biennium has been reduced to 3.3%, as described above. If the SBOE were to maintain a Distribution Rate in future years at the level set for 2012-13, prior to the enactment of the 2011 constitutional amendment, as the value of the real assets investments increase annually, distributions to the ASF would increase in the out years. The increased amounts distributed from the Fund will be a loss to either the investment corpus of the PSF managed by SBOE or, should the SLB increase its transfers to the SBOE to cover this share of the distribution, to the assets managed by the SLB. In addition, the changes made by the amendment will reduce the compounding interest in the Fund that would be derived from these assets remaining in the corpus of the Fund. Other factors that may affect the corpus of the Fund that are associated with this change include the decisions that are made by the SLB or others that are or may in the future be authorized to make transfers of funds from the PSF to the ASF. While the SBOE has oversight of the Guarantee Program, it will not have the decision making power with respect to all transfers to the ASF, as it has had in the past, which could adversely affect the ability of the SBOE to optimally manage its portion of the PSF assets.

Other Events and Disclosures

The State Investment Ethics Code governs the ethics and disclosure requirements for financial advisors and other service providers who advise certain State governmental entities, including the PSF. In accordance with the provisions of the State Investment Ethics Code, the SBOE periodically modifies its code of ethics, which occurred most recently in May 2010. The SBOE code of ethics includes prohibitions on sharing confidential information, avoiding conflict of interests and requiring disclosure filings with respect to contributions made or received in connection with the operation or management of the Fund. The code of ethics applies to members of the SBOE as well as to persons who are responsible by contract or by virtue of being a TEA PSF staff member for managing, investing, executing brokerage transactions, providing consultant services, or acting as a custodian of the PSF, and persons who provide investment and management advice to a member of the SBOE, with or without compensation under certain circumstances. The code of ethics is codified in the Texas Administrative Code at 19 TAC sections 33.5 et seq., and is available on the TEA web site at http://ritter.tea.state.tx.us/rules/tac/chapter033/index.html.

Since 2007, TEA has made supplemental appropriation requests to the Legislature for the purpose of funding the implementation of the 2008 Asset Allocation Policy, but those requests have been denied or partly funded. In the 2011 legislative session, the Legislature approved an increase of 31 positions in the full-time equivalent employees for the administration of the Fund, which was funded as part of an $18 million appropriation for each year of the 2012-13 biennium, in addition to the operational appropriation of $11 million for each year of the biennium. The TEA has begun increasing the PSF administrative staff in accordance with the 2011 legislative appropriation, and the TEA received an appropriation of $30.0 million for the administration of the PSF for each year of the 2014-15 biennium.

As of August 31, 2013, certain lawsuits were pending against the State and/or the GLO, which challenge the Fund's title to certain real property and/or past or future mineral income from that property, and other litigation arising in the normal course of the investment activities of the PSF. Reference is made to the Annual Report, when filed, for a description of such lawsuits that are pending, which may represent contingent liabilities of the Fund.

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

PSF Continuing Disclosure Undertaking

The SBOE has adopted an investment policy rule (the "TEA Rule") pertaining to the PSF and the Guarantee Program. The TEA Rule is codified in Section I of the TEA Investment Procedure Manual, which relates to the Guarantee Program and is posted to the TEA web site at http://tea.texas.gov/Finance_and_Grants/Permanent_School_Fund/. The most recent amendment to the TEA Rule was adopted by the SBOE on November 19, 2010, and is summarized below. Through the adoption of the TEA Rule and its commitment to guarantee bonds, the SBOE has made the following agreement for the benefit of the issuers, holders and beneficial owners of guaranteed bonds. The TEA (or its successor with respect to the management of the Guarantee Program) is required to observe the agreement for so long as it remains an "obligated person," within the meaning of Rule 15c2-12, with respect to guaranteed bonds. Nothing in the TEA Rule obligates the TEA to make any filings or disclosures with respect to guaranteed bonds, as the obligations of the TEA under the TEA Rule pertain solely to the Guarantee Program. The issuer or an "obligated person" of the guaranteed bonds has assumed the applicable obligation under Rule 15c-12 to make all disclosures and filings relating directly to guaranteed bonds, and the TEA takes no responsibility with respect to such undertakings. Under the

TEA agreement, the TEA will be obligated to provide annually certain updated financial information and operating data, and timely notice of specified material events, to the MSRB.

The MSRB has established the Electronic Municipal Market Access ("EMMA") system, and the TEA is required to file its continuing disclosure information using the EMMA system. Investors may access continuing disclosure information filed with the MSRB at www.emma.msrb.org, and the continuing disclosure filings of the TEA with respect to the PSF can be found at http://emma.msrb.org/IssueView/NonCUSIP9IssueDetails.aspx?id=ER355077 or by searching for "Texas Permanent School Fund Bond Guarantee Program" on EMMA.

Annual Reports

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

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

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

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

Material Event Notices

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

calls, debt service reserves, credit enhancement, liquidity enhancement, early redemption or the appointment of a trustee with respect to the Guarantee Program.) In addition, the TEA will provide timely notice of any failure by the TEA to provide information, data, or financial statements in accordance with its agreement described above under "Annual Reports."

Availability of Information

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

Limitations and Amendments

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

The continuing disclosure agreement of the TEA is made only with respect to the PSF and the Guarantee Program. The issuer of guaranteed bonds or an obligated person with respect to guaranteed bonds may make a continuing disclosure undertaking in accordance with Rule 15c2-12 with respect to its obligations arising under Rule 15c2-12 pertaining to financial and operating data concerning such entity and notices of material events relating to such guaranteed bonds. A description of such undertaking, if any, is included elsewhere in the Official Statement.

This continuing disclosure agreement may be amended by the TEA from time to time to adapt to changed circumstances that arise from a change in legal requirements, a change in law, or a change in the identity, nature, status, or type of operations of the TEA, but only if (1) the provisions, as so amended, would have permitted an underwriter to purchase or sell guaranteed bonds in the primary offering of such bonds in compliance with Rule 15c2-12, taking into account any amendments or interpretations of Rule 15c2-12 since such offering as well as such changed circumstances and (2) either (a) the holders of a majority in aggregate principal amount of the outstanding bonds guaranteed by the Guarantee Program consent to such amendment or (b) a person that is unaffiliated with the TEA (such as nationally recognized bond counsel) determines that such amendment will not materially impair the interest of the holders and beneficial owners of the bonds guaranteed by the Guarantee Program. The TEA may also amend or repeal the provisions of its continuing disclosure agreement if the SEC amends or repeals the applicable provision of Rule 15c2-12 or a court of final jurisdiction enters judgment that such provisions of the Rule are invalid, but only if and to the extent that the provisions of this sentence would not prevent an underwriter from lawfully purchasing or selling bonds guaranteed by the Guarantee Program in the primary offering of such bonds.

Compliance with Prior Undertakings

During the last five years, the TEA has not failed to substantially comply with its previous continuing disclosure agreements in accordance with Rule 15c2-12.

SEC Exemptive Relief

On February 9, 1996, the TEA received a letter from the Chief Counsel of the SEC that pertains to the availability of the "small issuer exemption" set forth in paragraph (d)(2) of Rule 15c2-12. The letter provides that Texas school districts which offer municipal securities that are guaranteed under the Guarantee Program may undertake to comply with the provisions of paragraph (d)(2) of Rule 15c2-12 if their offerings otherwise qualify for such exemption, notwithstanding the guarantee of the school district securities under the Guarantee Program. Among other requirements established by Rule 15c2-12, a school district offering may qualify for the small issuer exemption if, upon issuance of the proposed series of securities, the school district will have no more than $10 million of outstanding municipal securities.

STATE AND LOCAL FUNDING OF SCHOOL DISTRICTS IN TEXAS

Litigation Relating to the Texas Public School Finance System

On April 9, 2001, four property wealthy districts filed suit in the 250th District Court of Travis County, Texas (the "District Court") against the Texas Education Agency, the Texas State Board of Education, the Texas Commissioner of Education (the "Commissioner") and the Texas Comptroller of Public Accounts in a case styled *West Orange-Cove Consolidated Independent School District, et al. v. Neeley, et al*. The plaintiffs alleged that the $1.50 maximum maintenance and operations ("M&O") tax

rate had become in effect a state property tax, in violation of Article VIII, Section 1-e of the Texas Constitution, because it precluded them and other school districts from having meaningful discretion to tax at a lower rate. Forty school districts intervened alleging that the Texas public school finance system (the "Finance System") was inefficient, inadequate, and unsuitable, in violation of Article VII, Section 1 of the Texas Constitution, because the State of Texas (the "State") did not provide adequate funding. As described below, this case has twice reached the Texas Supreme Court (the "Supreme Court"), which rendered decisions in the case on May 29, 2003 ("West Orange-Cove I") and November 22, 2005 ("West Orange-Cove II"). After the remand by the Supreme Court back to the District Court in West Orange-Cove I, 285 other school districts were added as plaintiffs or intervenors. The plaintiffs joined the intervenors in their Article VII, Section 1 claims that the Finance System was inadequate and unsuitable, but not in their claims that the Finance System was inefficient.

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

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

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

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

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

In response to the intervenor districts' contention that the Finance System was constitutionally inefficient, the West Orange-Cove II decision states that the Texas Constitution does not prevent the Finance System from being structured in a manner that results in gaps between the amount of funding per student that is available to the richest districts as compared to the poorest district, but reiterated its statements in *Edgewood Independent School District v. Meno*, 917 S.W.2d 717 (Tex. 1995) ("Edgewood IV") that such funding variances may not be unreasonable. The Supreme Court further stated that "[t]he standards of Article VII, Section 1 - adequacy, efficiency, and suitability - do not dictate a particular structure that a system of free public schools must have." The Supreme Court also noted that "[e]fficiency requires only substantially equal access to revenue for facilities necessary for an adequate system," and the Supreme Court agreed with arguments put forth by the State that the plaintiffs had failed to present sufficient evidence to prove that there was an inability to provide for a "general diffusion of knowledge" without additional facilities.

Funding Changes in Response to West Orange-Cove II

In response to the decision in West Orange-Cove II, the Texas Legislature (the "Legislature") enacted House Bill 1 ("HB 1"), which made substantive changes in the way the Finance System is funded, as well as other legislation which, among other things, established a special fund in the State treasury to be used to collect new tax revenues that are dedicated under certain conditions for appropriation by the Legislature to reduce M&O tax rates, broadened the State business franchise tax, modified the

procedures for assessing the State motor vehicle sales and use tax and increased the State tax on tobacco products (HB 1 and other described legislation are collectively referred to herein as the "Reform Legislation"). The Reform Legislation generally became effective at the beginning of the 2006–07 fiscal year of each district.

Possible Effects of Litigation and Changes in Law on District Bonds

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

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

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

Current Litigation Related to the Texas Public School Finance System

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

All five suits were consolidated by the 250th District Court of Travis County (the "District Court"), and the trial commenced on October 22, 2012. On February 4, 2013, the District Court rendered a preliminary ruling (the substance of which was ultimately included in a final judgment rendered by the District Court on August 28, 2014, as further described below), but withheld

rendering a final judgment until the conclusion of the 83rd Regular Session of the Texas Legislature. The 83rd Regular Session of the Texas Legislature concluded on May 27, 2013, and on June 19, 2013, a hearing was held by the District Court at which the parties to the suits were directed to provide supplemental evidence to the District Court pertaining to new funding provided by the Legislature for the Finance System during the 83rd Regular Session. A trial to consider this evidence began on January 21, 2014 and concluded on February 7, 2014.

On August 28, 2014, the District Court rendered its final ruling, finding the current Finance System unconstitutional for the following reasons: (i) the Finance System effectively imposes a Statewide property tax in violation of the Texas Constitution because school districts lack "meaningful discretion" in the levy, assessment and disbursement of property taxes; (ii) the Finance System is structured, operated and funded in such a manner that prevents it from providing "a constitutionally adequate education for all Texas schoolchildren"; (iii) the Finance System "is constitutionally inadequate because it cannot accomplish, and has not accomplished, a general diffusion of knowledge for all students due to insufficient funding"; and (iv) the Finance System "is financially inefficient because all Texas students do not have substantially equal access to the educational funds necessary to accomplish a general diffusion of knowledge."

In the final ruling, the District Court enjoined the State from (i) enforcing Chapters 41 and 42 and Section 12.106 of the Education Code and (ii) distributing any money under the current Finance System until the constitutional violations are remedied. However, the District Court stayed the injunction until July 1, 2015, to give the 84th Texas Legislature, which convenes on January 13, 2015, an opportunity to cure the constitutional deficiencies in the Finance System. Pursuant to its terms, the injunction does not and will not impair the District's ability to levy, assess and collect ad valorem taxes, at the full rate and in the full amount authorized by law, necessary to make payments on the Bonds and, to the extent the District is entitled to receive State funding assistance for the payment of the Bonds under the current Finance System, the District will continue to be entitled to receive such State funding assistance. In addition, in response to arguments on behalf of the State's charter schools, the District Court held in its final ruling that it is within the discretion of the Legislature, and not unconstitutional, to fund charter schools differently from other public schools.

The State Defendants/Appellants filed a Notice of Direct Appeal to the Supreme Court on September 26, 2014. Notices of Cross-Direct Appeal were subsequently filed by four other parties. On January 6, 2015, the State Defendants/Appellants filed a Statement of Jurisdiction and Motion for Briefing Schedule requesting the Supreme Court note probable jurisdiction over the appeal and order the filing of appellate briefs in accordance with a proposed briefing schedule.

The Supreme Court noted probable jurisdiction on January 23, 2015 and set the following briefing schedule: Appellants' briefs were due (and were submitted on) April 13, 2015, Appellees' briefs were due (and were submitted on) July 2, 2015, and replies are due August 11, 2015. The Supreme Court will then set a date for oral arguments. It should be noted that the briefing schedule extends beyond the stayed injunction. Though pursuant to its terms, the District Court stayed its injunction until July 1, 2015, the Appellants' have taken the position that this stay has been automatically extended pending a final ruling by the Texas Supreme Court. See Neeley v. W. Orange-Cove Consol. Indep. Sch. District, 176 S.W.3d 746, 754 & n.19 (Tex. 2005) (noting the district court's injunction was stayed by the State's notice of appeal and citing as authority Tex. Civ. Prac. & Rem Code 6.01, which exempts the State from filing a supersedeas bond). Oral arguments before the Texas Supreme Court are scheduled for September 1, 2015.

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

2013 Legislative Session

The 83rd Texas Legislature concluded its regular session on May 27, 2013. During the session, the Legislature adopted a biennial budget that "restored" $3.2 billion of the $4 billion that was cut from basic state aid for the Finance System during the 2011 legislative session and some $100 million of the $1.3 billion cut from grant programs during the 2011 Legislative Session. See "CURRENT PUBLIC SCHOOL FINANCE SYSTEM – 2011 Legislative Session." The revenues that were added back to the Finance System do not take into account growing student enrollments in the State. The Legislature did not materially change the Finance System during the session.

2015 Legislative Session

On January 13, 2015, the 84th Texas Legislature convened in regular session, which ended on June 1, 2015. At this time the District has not made a comprehensive assessment of the anticipated impact during the 2016-2017 biennium of actions of the 84th Texas Legislature.

Before the next regular session of the Texas Legislature convenes in 2017, the Governor may call one or more special sessions of the Legislature that may include legislation affecting public school finance. During this time, the Legislature may enact laws that materially change current public school finance or affect ad valorem tax matters. The District can make no representation regarding any actions the Texas Legislature may take.

CURRENT PUBLIC SCHOOL FINANCE SYSTEM

Overview

The following description of the Finance System is a summary of the Reform Legislation and the changes made by the State Legislature to the Reform Legislation since its enactment, including modifications made during the regular through third called sessions of the 79th Texas Legislature in 2006, the regular session of the 81st Texas Legislature in 2009, the regular and first called sessions of the 82nd Texas Legislature in 2011, the regular session of the 83rd Texas Legislature in 2013, and the regular session of the 84th Texas Legislature in 2015. For a more complete description of school finance and fiscal management in the State, reference is made to Vernon's Texas Codes Annotated, Education Code, Chapters 41 through 46, as amended.

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

Local funding is derived from collections of ad valorem taxes levied on property located within each district's boundaries. School districts are authorized to levy two types of property taxes: a limited M&O tax to pay current expenses and an unlimited interest and sinking fund ("I&S") tax to pay debt service on bonds. Under current law, M&O tax rates are subject to a statutory maximum rate of $1.17 per $100 of taxable value for most school districts (a few districts can exceed the $1.17 limit as a result of authorization approved in the 1960's). Current law also requires school districts to demonstrate their ability to pay debt service on outstanding indebtedness through the levy of an ad valorem tax at a rate of not to exceed $0.50 per $100 of taxable property at the time bonds are issued. Once bonds are issued, however, districts may levy a tax to pay debt service on such bonds unlimited as to rate or amount (see "TAX INFORMATION – Tax Rate Limitations" herein). As noted above, because property values vary widely among school districts, the amount of local funding generated by the same tax rate is also subject to wide variation among school districts.

The Reform Legislation, which generally became effective at the beginning of the 2006–07 fiscal year, made substantive changes to the Finance System, which are summarized below. While each school district's funding entitlement was calculated based on the same formulas that were used prior to the 2006–07 fiscal year, the Reform Legislation made changes to local district funding by reducing each districts' 2005 M&O tax rate by one-third over two years through the introduction of the "State Compression Percentage," with M&O tax levies declining by approximately 11% in fiscal year 2006–07 and approximately another 22% in fiscal year 2007–08. (Prior to the Reform Legislation, the maximum M&O tax rate for most school districts was $1.50 per $100 of taxable assessed valuation. Because most school districts levied an M&O rate of $1.50 in 2005, the application of the Reform Legislation compression formula reduced the majority of school districts' M&O tax rates to $1.00). Subject to local referenda, a district may increase its local M&O tax rate from $1.04 up to the $1.17.

Local Funding for School Districts

The primary source of local funding for school districts is collections from ad valorem taxes levied against the taxable property located in each school district. As noted above, prior to the Reform Legislation, the maximum M&O tax rate for most school districts was generally limited to $1.50 per $100 of taxable value, and the majority of school districts were levying an M&O tax rate of $1.50 per $100 of taxable value at the time the Reform Legislation was enacted. The Reform Legislation required each school district to "compress" its tax rate by an amount equal to the "State Compression Percentage." For fiscal years 2007–08 through 2014–15, the State Compression Percentage has been set at 66.67%, effectively setting the maximum compressed M&O tax rate for most school districts at $1.00 per $100 of taxable value. The State Compression Percentage is set by legislative appropriation for each State fiscal biennium or, in the absence of legislative appropriation, by the Commissioner. School districts are permitted, however, to generate additional local funds by raising their M&O tax rate by $0.04 above the compressed tax rate without voter approval (for most districts, up to $1.04 per $100 of taxable value). In addition, if the voters approve ~~the~~ a tax rate increase through a local referenda, districts may, in general, increase their M&O tax rate up to a maximum M&O tax rate of $1.17 per $100 of taxable value and receive State equalization funds for such taxing effort (see "TAX INFORMATION – Public Hearing and Rollback Tax Rate" herein). Elections authorizing the levy of M&O taxes held in certain school districts under older laws, however, may subject M&O tax rates in such districts to other limitations (See "TAX INFORMATION – Tax Rate Limitations" herein).

State Funding for School Districts

State funding for school districts is provided through the Foundation School Program, which provides each school district with a minimum level of funding (a "Basic Allotment") for each student in average daily attendance ("ADA"). The Basic Allotment is calculated for each school district using various weights and adjustments based on the number of students in average daily attendance and also varies depending on each district's compressed tax rate. This Basic Allotment formula determines most of the allotments making up a district's Tier One entitlement. This basic level of funding is referred to as "Tier One" of the Foundation School Program. The basic level of funding is then "enriched" with additional funds known as "Tier Two" of the Foundation School Program. Tier Two provides a guaranteed level of funding for each cent of local tax effort that exceeds the compressed tax rate (for most districts, M&O tax rates above $1.00 per $100 of taxable value). The Finance System also provides an Existing Debt Allotment ("EDA") to subsidize debt service on eligible outstanding school district bonds and an Instructional Facilities Allotment ("IFA") to subsidize debt service on newly issued bonds. IFA primarily addresses the debt service needs of property-poor school districts. A New Instructional Facilities Allotment ("NIFA") also is available to help pay operational expenses associated with the opening of a new instructional facility; however, NIFA awards were not funded by the Legislature for either the 2012–13 or the 2014-15 State fiscal biennia. The 2015 Legislature did appropriate funds in the amount of $1,445,100,000 for the 2016-17 State fiscal biennium for an increase in the Basic Allotment, EDA, IFA, and NIFA support, as further described below.

Tier One and Tier Two allotments represent the State's share of the cost of M&O expenses of school districts, with local M&O taxes representing the district's local share. EDA and IFA allotments supplement a school district's local I&S taxes levied for debt service on eligible bonds issued to construct, acquire and improve facilities. Tier One and Tier Two allotments and existing EDA and IFA allotments are generally required to be funded each year by the Legislature. Since future-year IFA awards were not funded by the Legislature for the 2014–15 fiscal biennium ($55.5M has been appropriated for the 2016-17 school year), and debt service assistance on school district bonds that are not yet eligible for EDA is not available, debt service on new bonds issued by districts to construct, acquire and improve facilities must be funded solely from local I&S taxes.

Tier One allotments are intended to provide all districts a basic level of education necessary to meet applicable legal standards. Tier Two allotments are intended to guarantee each school district that is not subject to the wealth transfer provisions described below an opportunity to supplement that basic program at a level of its own choice; however, Tier Two allotments may not be used for the payment of debt service or capital outlay.

As described above, the cost of the basic program is based on an allotment per student known as the "Basic Allotment". For fiscal year 2014-15, the Basic Allotment is $5,040, and for fiscal years 2015-16 and 2016-17, the Basic Allotment is $5,140 for each student in average daily attendance. The Basic Allotment is then adjusted for all districts by several different weights to account for inherent differences between school districts. These weights consist of (i) a cost adjustment factor intended to address varying economic conditions that affect teacher hiring known as the "cost of education index", (ii) district-size adjustments for small and mid-size districts and (iii) an adjustment for the sparsity of the district's student population. The cost of education index and district-size adjustments applied to the Basic Allotment, create what is referred to as the "Adjusted Allotment". The Adjusted Allotment is used to compute a "regular program allotment," as well as various other allotments associated with educating students with other specified educational needs.

Tier Two supplements the basic funding of Tier One and provides two levels of enrichment with different guaranteed yields (i.e., guaranteed level of funding by the State) depending on the district's local tax effort. The first six cents of tax effort that exceeds the compressed tax rate (for most districts, M&O tax rates ranging from $1.01 to $1.06 per $100 of taxable value) will, for most districts, generate a guaranteed yield of $74.28 and $77.53 per weighted student in average daily attendance ("WADA") for the fiscal year 2015-16 and fiscal year 2016-17, respectively. The second level of Tier Two is generated by tax effort that exceeds the district's compressed tax rate plus six cents (for most districts eligible for this level of funding, M&O tax rates ranging from $1.06 to $1.17 per $100 of taxable value) and has a guaranteed yield per cent per WADA of $31.95 for fiscal years 2015-16 and 2016-17. Property-wealthy school districts that have an M&O tax rate that exceeds the district's compressed tax rate plus six cent are subject to recapture above this tax rate level at the equivalent wealth per student of $319,500 (see "Wealth Transfer Provisions" below).

Because districts with compressed rates of less than $1.00 have not been receiving the full Basic Allotment, the 2015 Legislature amended the Foundation School Program to enable some these districts (known as "fractionally funded districts") to increase the Tier 1 participation by moving the district's local tax effort that would be equalized under Tier 2 at $31.95 per penny to the Tier 1 Basic Allotment. The compressed tax rate of a school district that adopted a 2005 M&O Tax Rate below the maximum $1.50 tax rate for the 2005 tax year can now include the portion of a district's current M&O tax rate in excess of the first six cents above the district's compressed tax rate until the district's compressed tax rate is equal to the state maximum compressed tax rate of $1.00, thereby eliminating the penalty against the Basic Allotment. For these districts, each one cent of M&O tax levy above the district's compressed tax rate plus six cents, will have a guaranteed yield based on Tier One funding instead of the $31.95 Tier Two yield for the fiscal year 2015-16 and fiscal year 2016-17. These conversions would be optional for each applicable district in the 2015-16 and 2016-17 fiscal years and would be automatic beginning in the 2017-18 fiscal year.

In addition to the operations funding components of the Foundation School Program discussed above, the Foundation School Program provides a facilities funding component consisting of the Instructional Facilities Allotment (IFA) program and the Existing Debt Allotment (EDA) program. These programs assist school districts in funding facilities by, generally, equalizing a district's I&S tax effort. The IFA guarantees each awarded school district a specified amount per student (the "IFA Guaranteed Yield") in State and local funds for each cent of tax effort to pay the principal of and interest on eligible bonds issued to construct, acquire, renovate or improve instructional facilities. The guaranteed yield per cent of local tax effort per student in ADA has been $35 since this program first began in 1997. To receive an IFA award, a school district must apply to the Commissioner in accordance with rules adopted by the Commissioner before issuing the bonds to be paid with IFA state assistance. The total amount of debt service assistance over a biennium for which a district may be awarded is limited to the lesser of (1) the actual debt service payments made by the district in the biennium in which the bonds are issued; or (2) the greater of (a) $100,000 or (b) $250 multiplied by the number of students in ADA. The IFA is also available for lease-purchase agreements and refunding bonds meeting certain prescribed conditions. Once a district receives an IFA award for bonds, it is entitled to continue receiving State assistance for such bonds without reapplying to the Commissioner. The guaranteed level of State and local funds per student per cent of local tax effort applicable to the bonds may not be reduced below the level provided for the year in which the bonds were issued. For the fiscal years 2011-12, 2012-13, 2013-14, 2014-15, and 2015-16, no funds were appropriated for new IFA awards by the Legislature, although all prior obligations were funded throughout such periods. The 2015 Legislature appropriated funds in the amount of $55,500,000 for new IFA awards to be made during the 2016-17 fiscal year only.

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

A district may also qualify for a NIFA allotment, which provides assistance to districts for operational expenses associated with opening new instructional facilities. For the 2012-13 and 2014-15 State fiscal biennia, no funds were appropriated by the Legislature for new NIFA allotments. The 2015 Legislature did appropriate funds in the amount of $23,750,000 for each of the 2015-16 and 2016-17 fiscal years for NIFA allotments.

2006 Legislation

Since the enactment of the Reform Legislation in 2006, most school districts in the State have operated with a "target" funding level per student ("Target Revenue") that is based upon the "hold harmless" principles embodied in the Reform Legislation. This system of Target Revenue was superimposed on the Foundation School Program and made existing funding formulas substantially less important for most school districts. As noted above, the Reform Legislation was intended to lower M&O tax rates in order to give school districts "meaningful discretion" in setting their M&O tax rates, while holding school districts harmless by providing them with the same level of overall funding they received prior to the enactment of the Reform Legislation. Under the Target Revenue system, each school district is generally entitled to receive the same amount of revenue per student as it did in either the 2005–2006 or 2006–07 fiscal year (under existing laws prior to the enactment of the Reform Legislation), as long as the district adopted an M&O tax rate that was at least equal to its compressed rate. The reduction in local M&O taxes resulting from the mandatory compression of M&O tax rates under the Reform Legislation, by itself, would have significantly reduced the amount of local revenue available to fund the Finance System. To make up for this shortfall, the Reform Legislation authorized Additional State Aid for Tax Reduction ("ASATR") for each school district in an amount equal to the difference between the amount that each district would receive under the Foundation School Program and the amount of each district's Target Revenue funding level. However, subsequent Texas Legislatures have gradually reduced the reliance on ASATR by increasing the funding formulas. This phase-out of ASATR began with actions adopted by the 2013 Legislature. Beginning with the 2017-18 school year, the statutes authorizing ASATR are repealed.

Wealth Transfer Provisions

Some districts have sufficient property wealth per student in WADA ("wealth per student") to generate their statutory level of funding through collections of local property taxes alone. Districts whose wealth per student generates local property tax collections in excess of their statutory level of funding are referred to as "Chapter 41" districts because they are subject to the wealth equalization provisions contained in Chapter 41 of the Texas Education Code. Chapter 41 districts may receive State funds for certain competitive grants and a few programs that remain outside the Foundation School Program, as well as receiving

ASATR until their overall funding meets or exceeds their Target Revenue level of funding. Otherwise, Chapter 41 districts are not eligible to receive State funding. Furthermore, Chapter 41 districts must exercise certain options in order to reduce their wealth level to equalized wealth levels of funding, as determined by formulas set forth in the Reform Legislation. For most Chapter 41 districts, this equalization process entails paying the portion of the district's local taxes collected in excess of the equalized wealth levels of funding to the State (for redistribution to other school districts) or directly to other school districts with a wealth per student that does not generate local funds sufficient to meet the statutory level of funding; a process known as "recapture".

The equalized wealth levels that subject Chapter 41 districts to wealth equalization measures for fiscal year 2014–15 are set at (i) $504,000 per student in WADA with respect to that portion of a district's M&O tax effort that does not exceed its compressed tax rate (for most districts, the first $1.00 per $100 of taxable value) and (ii) $319,500 per WADA with respect to that portion of a district's M&O tax effort that is beyond its compressed rate plus $.06 (for most districts, M&O taxes levied above $1.06 per $100 in taxable value). For the 2015-16 fiscal year, the first equalized wealth level increases from $504,000 to $514,000, however the second equalized wealth level remains at $319,500. M&O taxes levied above $1.00 but below $1.07 per $100 of taxable value are not subject to the wealth equalization provisions of Chapter 41. Chapter 41 districts with a wealth per student above the lower equalized wealth level but below the higher equalized wealth level must equalize their wealth only with respect to the portion of their M&O tax rate, if any, in excess of $1.06 per $100 of taxable value. Chapter 41 districts may be entitled to receive ASATR from the State in excess of their recapture liability at the current $514,000, and such districts may use any funds distributed pursuant to Chapter 42 of the Texas Education Code, including their ASATR funds, to offset their recapture liability.

Under Chapter 41, a district has five options to reduce its wealth per student so that it does not exceed the equalized wealth levels: (1) a district may consolidate by agreement with one or more districts to form a consolidated district; all property and debt of the consolidating districts vest in the consolidated district; (2) a district may detach property from its territory for annexation by a property-poor district; (3) a district may purchase attendance credits from the State; (4) a district may contract to educate nonresident students from a property-poor district by sending money directly to one or more property-poor districts; or (5) a district may consolidate by agreement with one or more districts to form a consolidated taxing district solely to levy and distribute either M&O taxes or both M&O taxes and I&S taxes. A Chapter 41 district may also exercise any combination of these remedies. Options (3), (4) and (5) require prior approval by the Chapter 41 district's voters; Chapter 41 districts may apply any funds distributed pursuant to Chapter 42 of the Texas Education Code to offset recapture and to achieve the statutory wealth equalization requirements, as described above, without approval from voters.

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

Possible Effects of Wealth Transfer Provisions on the District's Financial Condition

The District's wealth per student for the current school year is greater that than the equalized wealth value. As a district with wealth per student in excess of the equalized wealth value, the District has reduced its wealth per student by exercising Option 3 pursuant to Chapter 41 of the Texas Education Code. As a so-called "Chapter 41 district", the District does not receive any State funding to pay debt service requirements on its outstanding indebtedness, including the Bonds. (See "CURRENT PUBLIC SCHOOL FINANCE SYSTEM – Wealth Transfer Provisions").

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

AD VALOREM TAX PROCEDURES

Property Tax Code and County-Wide Appraisal District

Title I of the Texas Tax Code (the "Property Tax Code") provides for county-wide appraisal and equalization of taxable property values and establishes in each county of the State an appraisal district and an appraisal review board responsible for appraising property for all taxing units within the county. The Hardeman and Wilbarger Counties Appraisal Districts (the "Appraisal Districts") are responsible for appraising property within the District, generally, as of January 1 of each year. The appraised values set by the Appraisal Districts are subject to review and change by an Appraisal Review Board of each Appraisal District

(collectively, the "Appraisal Review Board"), whose members are appointed by the Board of Directors of each Appraisal District. Such appraisal rolls, as approved by the Appraisal Review Board, are used by the District in establishing its tax roll and tax rate.

Property Subject to Taxation by the District

Except for certain exemptions provided by State law, all real and certain tangible personal property with a tax situs in the District is subject to taxation by the District. Principal categories of exempt property (including certain exemptions which are subject to local option by the Board of Trustees of the District) include property owned by the State or its political subdivisions if the property is used for public purposes; property exempt from ad valorem taxation by federal law; certain improvements to real property and certain tangible personal property located in designated reinvestment zones on which the District has agreed to abate ad valorem taxes; certain household goods, family supplies and personal effects; farm products owned by the producers; certain real property and tangible personal property owned by a non-profit community business organization or a charitable organization; and designated historic sites. Other principal categories of exempt property include tangible personal property not held or used for production of income; solar and windpowered energy devices; most individually owned automobiles; $10,000 exemption to residential homesteads of disabled persons or persons ages 65 or over; an exemption from $5,000 to a maximum of $12,000 for real or personal property of disabled veterans or the surviving spouses (so long as the surviving spouse remains unmarried) or children (under 18 years of age) of a deceased veteran who died while on active duty in the armed forces, with veterans who are 100% disabled (being a disabled veteran who receives from the United States Department of Veterans Affairs or its successor 100% disability compensation due to a service-connected disability and a rating of 100% disabled or of individual unemployability) or such veterans surviving spouse (so long as the surviving spouse remains unmarried) entitled to an exemption from taxation of the total appraised value of the veteran's residential homestead; an exemption for a partially disabled veteran or certain surviving spouses of partially disabled veterans of a percentage of the appraised value of their residence homestead in an amount equal to the partially disabled veteran's disability rating if the residence homestead was donated by a charitable organization; an exemption for the surviving spouse of a member of the armed forces who was killed in action is, subject to certain conditions, of the total appraised value of the surviving spouse's residence homestead, and subject to certain conditions, an exemption up to the same amount may be transferred to a subsequent residence homestead of the surviving spouse; $15,000 in market value for all residential homesteads; and certain classes of intangible property. In addition, except for increases attributable to certain improvements, the District is prohibited by State law from increasing the total ad valorem tax of the residence homestead of persons 65 years of age or older above the amount of tax imposed in the year such residence qualified for an exemption based on age of the owner. The freeze on ad valorem taxes on the homesteads of persons 65 years of age or older is also transferable to a different residence homestead. Also, a surviving spouse of a taxpayer who qualifies for the freeze on ad valorem taxes is entitled to the same exemption so long as (i) the taxpayer died in a year in which he qualified for the exemption, (ii) the surviving spouse was at least 55 years of age when the taxpayer died and (iii) the property was the residence homestead of the surviving spouse when the taxpayer died and the property remains the residence homestead of the surviving spouse. The freeze on taxes paid on residence homesteads of persons 65 years of age and older was extended to include the resident homesteads of "disabled" persons, including the right to transfer the freeze to a different residence homestead. A "disabled" person is one who is "under a disability for purposes of payment of disability insurance benefits under the Federal Old Age, Survivors and Disability Insurance." Pursuant to a constitutional amendment approved by the voters on May 12, 2007, legislation was enacted to reduce the school property tax limitation imposed by the freeze on taxes paid on residence homesteads of persons 65 years of age or over or of disabled persons to correspond to reductions in local school district tax rates from the 2005 tax year to the 2006 tax year and from the 2006 tax year to the 2007 tax year (see "CURRENT PUBLIC SCHOOL FINANCE SYSTEM – General"). The school property tax limitation provided by the constitutional amendment and enabling legislation apply to the 2007 and subsequent tax years. Owners of agricultural and open space land, under certain circumstances, may request valuation of such land on the basis of productive capacity rather than market value.

Article VIII, Section 1-j of the Texas Constitution provides for an exemption from ad valorem taxation for "freeport property," which is defined as goods detained in the state for 175 days or less for the purpose of assembly, storage, manufacturing, processing or fabrication. Taxing units that took action prior to April 1, 1990 may continue to tax freeport property and decisions to continue to tax freeport property may be reversed in the future. However, decisions to exempt freeport property are not subject to reversal.

Article VIII, Section 1-n of the Texas Constitution provides for the exemption from taxation of "goods-in-transit." "Goods-in-transit" is defined by Section 11.253 of the Tax Code, which is effective for tax years 2008 and thereafter, as personal property acquired or imported into Texas and transported to another location in the State or outside of the State within 175 days of the date the property was acquired or imported into Texas. The exemption excludes oil, natural gas, petroleum products, aircraft and special inventory, including motor vehicle, vessel and out-board motor, heavy equipment and manufactured housing inventory. Section 11.253 of the Tax Code permits local governmental entities, on a local option basis, to take official action by January 1 of the year preceding a tax year, after holding a public hearing, to tax "goods-in-transit" during the following tax year. A taxpayer may only receive either the freeport exemption or the "goods-in-transit" exemption for items of personal property. See "Appendix A – Financial Information Regarding the District" for a schedule of exemptions allowed by the District.

A city or county may create a tax increment financing district ("TIF") within the city or county with defined boundaries and establish a base value of taxable property in the TIF at the time of its creation. Overlapping taxing units, including school districts, may agree with the city or county to contribute all or part of future ad valorem taxes levied and collected against the "incremental value" (taxable value in excess of the base value) of taxable real property in the TIF to pay or finance the costs of

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

Valuation of Property for Taxation

Generally, property in the District must be appraised by the Appraisal District at market value as of January 1 of each year. In determining the market value of property, different methods of appraisal may be used, including the cost method of appraisal, the income method of appraisal or the market data comparison method of appraisal, and the method considered most appropriate by the chief appraiser is to be used. Once an appraisal roll is prepared and finally approved by the Appraisal Review Board, it is used by the District in establishing its tax rolls and tax rate. Assessments under the Property Tax Code are based on one hundred percent (100%) of market value, except as described below, and no assessment ratio can be applied.

State law requires the appraised value of a residence homestead to be based solely on the property's value as a residence homestead, regardless of whether residential use is considered to be the highest and best use of the property. State law further limits the appraised value of a residence homestead for a tax year to an amount not to exceed the lesser of (1) the property's market value in the most recent tax year in which the market value was determined by the Appraisal District or (2) the sum of (a) 10% of the property's appraised value for the preceding tax year, (b) the appraised value of the property for the preceding tax year; and (c) the market value of all new improvements to the property.

The Property Tax Code permits land designated for agricultural use, open space or timberland to be appraised at its value based on the land's capacity to produce agricultural or timber products rather than at its fair market value. Landowners wishing to avail themselves of the agricultural use designation must apply for the designation, and the appraiser is required by the Property Tax Code to act on each claimant's right to the designation individually. If a claimant receives the designation and later loses it by changing the use of the property or selling it to an unqualified owner, the District can collect taxes for previous years based on the new value, including three years for agricultural use and five years for agricultural open-space land and timberland prior to the loss of the designation.

The Property Tax Code requires the Appraisal District to implement a plan for periodic reappraisal of property to update appraisal values. The plan must provide for appraisal of all real property in the Appraisal District at least once every three years. The District, at its expense, has the right to obtain from the Appraisal District a current estimate of appraised values within the District or an estimate of any new property or improvements within the District. While such current estimate of appraisal values may serve to indicate the rate and extent of growth of taxable values within the District, it cannot be used for establishing a tax rate within the District until such time as the Appraisal District choose to formally include such values on their appraisal roll.

Residential Homestead Exemption

Under Section 1-b, Article VIII of the Texas Constitution and State law, the governing body of a political subdivision, at its option, may grant an exemption of not less than $3,000 of market value of the residence homestead of persons 65 years of age or older and the disabled from all ad valorem taxes thereafter levied by the political subdivision. Once authorized, such exemption may be repealed or decreased or increased in amount (i) by the governing body of the political subdivision or (ii) by a favorable vote of a majority of the qualified voters at an election called by the governing body of the political subdivision, which election must be called upon receipt of a petition signed by at least 20% of the number of qualified voters who voted in the preceding election of the political subdivision. In the case of a decrease, the amount of the exemption may not be reduced to less than $3,000 of the market value.

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

In addition to any other exemptions provided by the Property Tax Code, the governing body of a political subdivision, at its option, may grant an exemption of up to 20% of the market value of residence homesteads, with a minimum exemption of $5,000.

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

During the 84th Texas Legislature, which concluded on June 1, 2015, Senate Joint Resolution 1, was passed, which proposes a constitutional amendment increasing the mandatory homestead exemption for school districts from $15,000 to $25,000 and requiring that the tax limitation for taxpayers who are age 65 and older or disabled be reduced to reflect the additional exemption. If approved by the voters at an election to be held on November 3, 2015, the proposed amendment to the Constitution will be effective for the tax year beginning January 1, 2015.

Senate Bill 1, which was also passed during the 84th Texas Legislature, makes provisions based on the election outcome of the constitutional amendment proposed in SJR 1 for either (1) additional state aid to hold school districts harmless for tax revenue losses resulting from the increased homestead exemption or (2) the tax assessor for a school district to mail a supplemental tax bill to taxpayers in the district to account for the difference in taxable assessed value of the residence homestead based on the lower exemption amount provided under current law.

District and Taxpayer Remedies

Under certain circumstances, taxpayers and taxing units, including the District, may appeal orders of the Appraisal Review Board by filing a petition for review in district court within 45 days after notice is received that a final order has been entered. In such event, the property value in question may be determined by the court, or by a jury, if requested by any party, or through binding arbitration, if requested by the taxpayer. Additionally, taxing units may bring suit against the Appraisal District to compel compliance with the Property Tax Code

Public Hearing and Rollback Tax Rate

In setting its annual tax rate, the governing body of a school district generally cannot adopt a tax rate exceeding the district's "rollback tax rate" without approval by a majority of the voters voting at an election approving the higher rate. The tax rate consists of two components: (1) a rate for funding of maintenance and operation expenditures and (2) a rate for debt service. The rollback tax rate for a school district is the lesser of (A) the sum of (1) the product of the district's "State Compression Percentage" for that year multiplied by $1.50, (2) the rate of $0.04, (3) any rate increase above the rollback tax rate in prior years that were approved by voters, and (4) the district's current debt rate, or (B) the sum of (1) the district's effective maintenance and operations tax rate, (2) the product of the district's State Compression Percentage for that year multiplied by $0.06; and (3) the district's current debt rate (see "CURRENT PUBLIC SCHOOL FINANCE SYSTEM - Local Funding for School Districts" for a description of the "State Compression Percentage"). If for the preceding tax year a district adopted an M&O tax rate that was less than its effective M&O tax rate for that preceding tax year, the district's rollback tax for the current year is calculated as if the district had adopted an M&O tax rate for the preceding tax year equal to its effective M&O tax rate for that preceding tax year.

The "effective maintenance and operations tax rate" for a school district is the tax rate that, applied to the current tax values, would provide local maintenance and operating funds, when added to State funds to be distributed to the district pursuant to Chapter 42 of the Texas Education Code for the school year beginning in the current tax year, in the same amount as would have been available to the district in the preceding year if the funding elements of wealth equalization and State funding for the current year had been in effect for the preceding year.

Section 26.05 of the Property Tax Code provides that the governing body of a taxing unit is required to adopt the annual tax rate for the unit before the later of September 30 or the 60th day after the date the certified appraisal roll is received by the taxing unit, and a failure to adopt a tax rate by such required date will result in the tax rate for the taxing unit for the tax year to be the lower of the effective tax rate calculated for that tax year or the tax rate adopted by the taxing unit for the preceding tax year. Before adopting its annual tax rate, a public meeting must be held for the purpose of adopting a budget for the succeeding year. A notice of public meeting to discuss budget and proposed tax rate must be published in the time, format and manner prescribed in Section 44.004 of the Texas Education Code. Section 44.004(e) of the Texas Education Code provides that a person who owns taxable property in a school district is entitled to an injunction restraining the collection of taxes by the district if the district has not complied with such notice requirements or the language and format requirements of such notice as set forth in Section 44.004(b), (c) and (d) and if such failure to comply was not in good faith. Section 44.004(e) further provides the action to enjoin the

collection of taxes must be filed before the date the district delivers substantially all of its tax bills. A district may adopt its budget after adopting a tax rate for the tax year in which the fiscal year covered by the budget begins if the district elects to adopt its tax rate before receiving the certified appraisal roll. A district that adopts a tax rate before adopting its budget must hold a public hearing on the proposed tax rate followed by another public hearing on the proposed budget rather than holding a single hearing on the two items.

Levy and Collection of Taxes

The District is responsible for the collection of its taxes, unless it elects to transfer such functions to another governmental entity. Before the later of September 30 or the 60th day after the date that the certified appraisal role is received by the District, the rate of taxation must be set by the Board of Trustees of the District based upon the valuation of property within the District as of the preceding January 1 and the amount required to be raised for debt service and maintenance and operations purposes. Taxes are due October 1, or when billed, whichever comes later, and become delinquent after January 31 of the following year. A delinquent tax incurs a penalty from six percent (6%) to twelve percent (12%) of the amount of the tax, depending on the time of payment, and accrues interest at the rate of one percent (1%) per month. If the tax is not paid by the following July 1, an additional penalty of up to twenty percent (20%) may, under certain circumstances, be imposed by the District. The Property Tax Code also makes provision for the split payment of taxes, discounts for early payment and the postponement of the delinquency date of taxes under certain circumstances.

District's Rights in the Event of Tax Delinquencies

Taxes levied by the District are a personal obligation of the owner of the property. The District has no lien for unpaid taxes on personal property but does have a lien for unpaid taxes on real property, which lien is discharged upon payment. On January 1 of each year, such tax lien attaches to property to secure the payment of all taxes, penalties, and interest ultimately imposed for the year on the property. The District's tax lien is on a parity with the tax liens of other such taxing units. A tax lien on real property takes priority over the claims of most creditors and other holders of liens on the property encumbered by the tax lien, whether or not the debt or lien existed before the attachment of the tax lien. The automatic stay in bankruptcy will prevent the automatic attachment of tax liens with respect to post-petition tax years unless relief is sought and granted by the bankruptcy judge. Personal property, under certain circumstances, is subject to seizure and sale for the payment of delinquent taxes, penalty, and interest.

Except with respect to taxpayers who are 65 years of age or older, at any time after taxes on property become delinquent, the District may file suit to foreclose the lien securing payment of the tax, to enforce personal liability for the tax, or both. In filing a suit to foreclose a tax lien on real property, the District must join other taxing units that have claims for delinquent taxes against all or part of the same property. Collection of delinquent taxes may be adversely affected by the amount of taxes owed to other taxing units, by the effects of market conditions on the foreclosure sale price, by taxpayer redemption rights, or by bankruptcy proceedings which restrict the collection of taxpayer debts.

Collection of Taxes - Penalty and Interest Charges

The Board of Trustees has approved a resolution initiating an additional 20% penalty to defray attorney costs in the collection of delinquent taxes over and above the penalty automatically assessed under the Tax Code. Charges for penalties and interest on the unpaid balance of delinquent taxes are as follows:

Month	Cumulative Penalty	Cumulative Interest[(b)]	Total
February	6%	1%	7%
March	7	2	9
April	8	3	11
May	9	4	13
June	10	5	15
July	32[(a)]	6	38

[(a)] Includes additional penalty of 20% assessed after July 1 in order to defray attorney collection expenses.
[(b)] Taxes delinquent after July 1 incur an additional interest penalty of 20% of the sum of the delinquent taxes plus the penalties and interest to defray attorney collection fees.

Property within the District is assessed as of January 1 of each year (except business inventories which may be assessed as of September 1 and mineral values which are assessed on the basis of a twelve month average) taxes become due October 1 of the same year and become delinquent on February 1 of the following year. Split payments are not permitted. Discounts are not permitted.

EMPLOYEES' BENEFIT PLANS

The District's employees participate in a retirement plan (the "Plan") with the State of Texas. The Plan is administered by the Teacher Retirement System of Texas ("TRS"). State contributions are made to cover costs of the TRS retirement plan up to

certain statutory limits. The District is obligated for a portion of TRS, costs relating to employee salaries that exceed the statutory limit. (See "Appendix B - CHILLICOTHE INDEPENDENT SCHOOL DISTRICT ANNUAL FINANCIAL REPORT.") In addition to the TRS retirement plan, the District provides health care coverage for its employees.

Formal collective bargaining agreements relating directly to wages and other conditions of employment are prohibited by Texas law, as are strikes by teachers. There are various local, state, and national organized employee groups who engage in efforts to better the terms and conditions of employment of school employees. Some districts have adopted a policy to consult with employer groups with respect to certain terms and conditions of employment. Some examples of these groups are the Texas State Teachers Association, the Texas Classroom Teachers Association, the Association of Texas Professional Educators, and the National Education Association.

TAX RATE LIMITATIONS

A school district is authorized to levy maintenance and operation ("M&O") taxes subject to approval of a proposition submitted to district voters. The maximum M&O tax rate that may be levied by a district cannot exceed the voted maximum rate or the maximum rate described in the next succeeding paragraph. The maximum voted M&O tax rate for the District is $1.50 per $100 of assessed valuation as approved by the voters pursuant to 2784e-1, Texas Revised Civil Statues Annotated, as amended ("Article 2784e-1). Article 2784e-1 limits the District's annual M&O tax rate based upon a comparison between the District's outstanding bonded indebtedness and the District's taxable assessed value per $100 of assessed valuation. Article 2784e-1 provides for a reduction of $0.10 for each one percent (1%) or major fraction thereof increase in bonded indebtedness beyond seven percent (7%) of assessed valuation of property in the District. This limitation is capped when the District's bonded indebtedness is ten percent (10%) (or greater) of the District's assessed valuation which would result in an annual M&O tax rate not to exceed $1.20. Lastly, the Texas Attorney General in reviewing the District's transcript of proceedings will allow the District to reduce the amount of its outstanding bonded indebtedness by the amount of funds (on a percentage basis) that the District receives in State assistance for the repayment of this bonded indebtedness (For example, if the District anticipates that it will pay 75% of its bonded indebtedness from State assistance, for the purposes of Article 2784e-1, the Texas Attorney General will assume that only 25% of the District's bonded indebtedness is outstanding and payable from local ad valorem taxes). The bonded indebtedness of the District after the issuance of the Bonds will be approximately 1.70% of the District's current taxable assessed valuation of property. See "TAX INFORMATION - Table 1 Valuation, Exemptions and Tax Supported Debt" herein.

The maximum tax rate per $100 of assessed valuation that may be adopted by the District may not exceed the lesser of (A) $1.50, or such lower rate as described in the preceding paragraph, and (B) the sum of (1) the rate of $0.17, and (2) the product of the "State Compression Percentage" multiplied by $1.50. The State Compression Percentage has been set, and will remain, at 66.67% for fiscal years 2007–08 through 2014–15. The State Compression Percentage is set by legislative appropriation for each State fiscal biennium or, in the absence of legislative appropriation, by the Commissioner. For a more detailed description of the State Compression Percentage, see "CURRENT PUBLIC SCHOOL FINANCE SYSTEM - Local Funding for School Districts". Furthermore, a school district cannot annually increase its tax rate in excess of the district's "rollback tax rate" without submitting such tax rate to a referendum election and a majority of the voters voting at such election approving the adopted rate. See "AD VALOREM TAX PROCEDURES - Public Hearing and Rollback Tax Rate."

A school district is also authorized to issue bonds and levy taxes for payment of bonds subject to voter approval of a proposition submitted to the voters under Section 45.003(b)(1), Texas Education Code, as amended, which provides a tax unlimited as to rate or amount for the support school district bonded indebtedness (see "THE BONDS - Security and Source of Payment").

Section 45.0031, Texas Education Code, as amended ("Section 45.0031"), requires a district to demonstrate to the Texas Attorney General that it has the prospective ability to pay its maximum annual debt service on a proposed issue of bonds and all previously issued bonds, other than bonds approved by district voters at an election held on or before April 1, 1991 and issued before September 1, 1992 (or debt issued to refund such bonds, collectively, "exempt bonds"), from a tax levied at a rate of $0.50 per $100 of assessed valuation before bonds may be issued. In demonstrating the ability to pay debt service at a rate of $0.50, a district may take into account EDA and IFA allotments to the district, which effectively reduces the district's local share of debt service, and may also take into account Tier One funds allotted to the district. The District is required to deposit any State allotments provided solely for payment of debt service into the District's interest and sinking fund upon receipt of such amounts. In addition, the District must, prior to levying an interest and sinking fund tax rate that exceeds $0.50 per $100 of assessed valuation, credit to the interest and sinking fund other State assistance, including Tier One funds that may be used for either operating purposes or for payment of debt service, in an amount equal to the amount needed to demonstrate compliance with the threshold tax rate test and which is received or to be received in that year. Once the prospective ability to pay such tax has been shown and the bonds are issued, a district may levy an unlimited tax to pay debt service. Taxes levied to pay refunding bonds issued pursuant to Chapter 1207, Texas Government Code, are not subject to the $0.50 tax rate test; however, taxes levied to pay debt service on such bonds (other than bonds issued to refund exempt bonds) are included in maximum annual debt service for calculation of the $0.50 threshold tax rate test when applied to subsequent bond issues. The Bonds are issued for school building purposes pursuant to Chapter 45, Texas Education Code as new debt and are subject to the threshold tax rate test. Under current law, a district may demonstrate its ability to comply with the $0.50 threshold tax rate test by applying the $0.50 tax rate to an amount equal to 90% of projected future taxable value of property in the district, as certified by a registered professional appraiser, anticipated for the earlier of the tax year five years after the current tax year or the tax year in which the final payment for the bonds is due. However, if a district uses projected future taxable values to meet the $0.50 threshold tax rate test and

subsequently imposes a tax at a rate greater than $0.50 per $100 of valuation to pay for bonds subject to the test, then for subsequent bond issues, the Attorney General must find that the district has the projected ability to pay principal and interest on the proposed bonds and all previously issued bonds subject to the $0.50 threshold tax rate test from a tax rate of $0.45 per $100 of valuation. The District has not used projected property values to satisfy this threshold test.

INVESTMENTS

The District invests its investable funds in investments authorized by Texas law in accordance with investment policies approved by the Board. Both state law and the District's investment policies are subject to change. See Table 12 in APPENDIX A for a description of the District's investments as of May 1, 2015.

Legal Investments

Under Texas law, the District is authorized to invest in (1) obligations of the United States or its agencies and instrumentalities, including letters of credit; (2) direct obligations of the State of Texas or its agencies and instrumentalities; (3) collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or instrumentality of the United States; (4) other obligations, the principal and interest of which is guaranteed or insured by or backed by the full faith and credit of, the State of Texas or the United States or their respective agencies and instrumentalities, including obligations that are fully guaranteed or insured by the Federal Deposit Insurance Corporation or by the explicit full faith and credit of the United States; (5) obligations of states, agencies, counties, cities, and other political subdivisions of any state rated as to investment quality by a nationally recognized investment rating firm not less than "A" or its equivalent; (6) bonds issued, assumed or guaranteed by the State of Israel; (7) certificates of deposit (i) meeting the requirements of the Texas Public Funds Investment Act (Chapter 2256, Texas Government Code) that are issued by or through an institution that either has its main office or a branch in Texas, and are guaranteed or insured by the Federal Deposit Insurance Corporation or the National Credit Union Share Insurance Fund, or are secured as to principal by obligations described in clauses (1) through (6) or in any other manner and amount provided by law for District deposits or, (ii) where (a) the funds are invested by the District through (I) a broker that has its main office or a branch office in the State of Texas and is selected from a list adopted by the District as required by law or (II) a depository institution that has its main office or a branch office in the State of Texas that is selected by the District; (iii) the broker or the depository institution selected by the District arranges for the deposit of the funds in certificates of deposit in one or more federally insured depository institutions, wherever located, for the account of the District; (iv) the full amount of the principal and accrued interest of each of the certificates of deposit is insured by the United States or an instrumentality of the United States, and (v) the District appoints the depository institution selected under (ii) above, an entity as described by Section 2257.041(d) of the Texas Government Code, or a clearing broker-dealer registered with the Securities and Exchange Commission and operating pursuant to Securities and Exchange Commission Rule 15c3-3 (17 C.F.R. Section 240.15c3-3) as custodian for the District with respect to the certificates of deposit issued for the account of the District; (8) fully collateralized repurchase agreements that have a defined termination date, are secured by a combination of cash and obligations described in clause (1) require the securities being purchased by the District or cash held by the District to be pledged to the District, held in the District's name, and deposited at the time the investment is made with the District or with a third party selected and approved by the District, and are placed through a primary government securities dealer, as defined by the Federal Reserve, or a financial institution doing business in the State; (9) certain bankers' acceptances with the remaining term of 270 days or less, if the short-term obligations of the accepting bank or its parent are rated at least "A-1" or "P-1" or the equivalent by at least one nationally recognized credit rating agency; (10) commercial paper with a stated maturity of 270 days or less that is rated at least "A-1" or "P-1" or the equivalent by either (a) two nationally recognized credit rating agencies or (b) one nationally recognized credit rating agency if the paper is fully secured by an irrevocable letter of credit issued by a U.S. or state bank; (11) no-load money market mutual funds registered with and regulated by the Securities and Exchange Commission that have a dollar weighted average stated maturity of 90 days or less and include in their investment objectives the maintenance of a stable net asset value of $1 for each share; and (12) no-load mutual funds registered with the Securities and Exchange Commission that have an average weighted maturity of less than two years, invest exclusively in obligations described in the this paragraph, and are continuously rated as to investment quality by at least one nationally recognized investment rating firm of not less than "AAA" or its equivalent. In addition, bond proceeds may be invested in guaranteed investment contracts that have a defined termination date and are secured by obligations, including letters of credit, of the United States or its agencies and instrumentalities in an amount at least equal to the amount of bond proceeds invested under such contract, other than the prohibited obligations described below.

A political subdivision such as the District may enter into securities lending programs if (i) the securities loaned under the program are 100% collateralized, a loan made under the program allows for termination at any time and a loan made under the program is either secured by (a) obligations that are described in clauses (1) through (6) above, (b) irrevocable letters of credit issued by a state or national bank that is continuously rated by a nationally recognized investment rating firm at not less than A or its equivalent or (c) cash invested in obligations described in clauses (1) through (6) above, clauses (10) through (12) above, or an authorized investment pool; (ii) securities held as collateral under a loan are pledged to the District, held in the District's name and deposited at the time the investment is made with the District or a third party designated by the District; (iii) a loan made under the program is placed through either a primary government securities dealer or a financial institution doing business in the State of Texas; and (iv) the agreement to lend securities has a term of one year or less.

The District may invest in such obligations directly or through government investment pools that invest solely in such obligations provided that the pools are rated no lower than "AAA" or "AAAm" or an equivalent by at least one nationally recognized rating service. The District may also contract with an investment management firm registered under the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-1 et seq.) or with the State Securities Board to provide for the investment and management of its public funds or other funds under its control for a term up to two years, but the District retains ultimate responsibility as fiduciary of its assets. In order to renew or extend such a contract, the District must do so by order, ordinance, or resolution.

The District is specifically prohibited from investing in: (1) obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal; (2) obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security and bears no interest; (3) collateralized mortgage obligations that have a stated final maturity of greater than 10 years; and (4) collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index.

Investment Policies

Under Texas law, the District is required to invest its funds under written investment policies that primarily emphasize safety of principal and liquidity; that address investment diversification, yield, maturity, and the quality and capability of investment management; and that include a list of authorized investments for District funds, the maximum allowable stated maturity of any individual investment and the maximum average dollar-weighted maturity allowed for pooled fund groups, methods to monitor the market price of investments acquired with public funds, a requirement for settlement of all transactions, except investment pool funds and mutual funds, on a delivery versus payment basis, and procedures to monitor rating changes in investments acquired with public funds and the liquidation of such investments consistent with the Texas Public Funds Investment Act. All District funds must be invested consistent with a formally adopted "Investment Strategy Statement" that specifically addresses each fund's investment. Each Investment Strategy Statement will describe its objectives concerning: (1) suitability of investment type, (2) preservation and safety of principal, (3) liquidity, (4) marketability of each investment, (5) diversification of the portfolio, and (6) yield.

Under Texas law, the District's investments must be made "with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment considering the probable safety of capital and the probable income to be derived." At least quarterly the District's investment officers must submit an investment report to the Board of Trustees detailing: (1) the investment position of the District, (2) that all investment officers jointly prepared and signed the report, (3) the beginning market value, and any additions and changes to market value and the ending value of each pooled fund group, (4) the book value and market value of each separately listed asset at the beginning and end of the reporting period, (5) the maturity date of each separately invested asset, (6) the account or fund or pooled fund group for which each individual investment was acquired, and (7) the compliance of the investment portfolio as it relates to: (a) adopted investment strategies and (b) Texas law. No person may invest District funds without express written authority from the Board of Trustees.

Additional Provisions

Under Texas law, the District is additionally required to: (1) annually review its adopted policies and strategies, (2) require any investment officers with personal business relationships or family relationships with firms seeking to sell securities to the District to disclose the relationship and file a statement with the Texas Ethics Commission and the District, (3) require the registered principal of firms seeking to sell securities to the District to: (a) receive and review the District's investment policy, (b) acknowledge that reasonable controls and procedures have been implemented to preclude imprudent investment activities, and (c) deliver a written statement attesting to these requirements; (4) in conjunction with its annual financial audit, perform a compliance audit of the management controls on investments and adherence to the District's investment policy, (5) restrict reverse repurchase agreements to not more than 90 days and restrict the investment of reverse repurchase agreement funds to no greater than the term of the reverse repurchase agreement, (6) restrict the investment in non-money market mutual funds in the aggregate to no more than 15% of the District's monthly average fund balance, excluding bond proceeds and reserves and other funds held for debt service, (7) require local government investment pools to conform to the new disclosure, rating, net asset value, yield calculation, and advisory board requirements and (8) provide specific investment training for the Treasurer, the chief financial officer (if not the Treasurer) and the investment officer.

TAX MATTERS

Opinion of Co-Bond Counsel – Federal Income Tax Status of Interest

Co-Bond Counsel's opinion will state that, under current law, (i) interest on the Bonds (including any accrued "original issue discount" properly allocable to the owners of such Bonds) is excludable from gross income for purposes of federal income taxation under Section 103 of the Internal Revenue Code of 1986, as amended (the "Code") and (ii) interest on the Bonds is not a specific item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations; provided, however, for purposes of the alternative minimum tax imposed on corporations (as defined for federal income tax purposes under Section 56 of the Code), interest on the Bonds is included in computing adjusted current earnings.

Co-Bond Counsel will express no opinion regarding other federal tax consequences arising with respect to the Bonds.

Co-Bond Counsel's opinion speaks as of its date, is based on current legal authority and precedent, covers certain matters not directly addressed by such authority and precedent, and represents Co-Bond Counsel's judgment as to the proper treatment of interest on the Bonds for federal income tax purposes under Section 103 of the Code. Co-Bond Counsel's opinion does not contain or provide any opinion or assurance regarding the future activities of the District or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or the enforcement thereof by the Internal Revenue Service (the "IRS"). The District has covenanted, however, to comply with the requirements of the Code.

Reliance and Assumptions; Effect of Certain Changes

In delivering its opinion regarding the treatment of interest on the Bonds, Co-Bond Counsel is relying upon certifications of representatives of the District, the underwriter of such Bonds, and other persons as to facts material to the opinion, which Co-Bond Counsel has not independently verified.

In addition, Co-Bond Counsel is assuming continuing compliance with the Covenants (as hereinafter defined) by the District. The Code and the regulations promulgated thereunder contain a number of requirements that must be satisfied after the issuance of the Bonds in order for interest on the Bonds to be and remain excludable from gross income for purposes of federal income taxation. These requirements include, by way of example and not limitation, restrictions on the use, expenditure and investment of the proceeds of the Bonds and the use of the property financed by such Bonds, limitations on the source of the payment of and the security for such Bonds and the obligation to rebate certain excess earnings on the gross proceeds of such Bonds to the United States Treasury. The tax compliance agreement to be entered into by the District with respect to the Bonds contains covenants (the "Covenants") under which the District has agreed to comply with such requirements. Failure by the District to comply with the Covenants could cause interest on the Bonds to become includable in gross income for federal income tax purposes retroactively to their date of issue. In the event of noncompliance with the Covenants, the available enforcement remedies may be limited by applicable provisions of law and, therefore, may not be adequate to prevent interest on the Bonds from becoming includable in gross income for federal income tax purposes.

Co-Bond Counsel has no responsibility to monitor compliance with the Covenants after the date of issue of the Bonds.

Certain requirements and procedures contained, incorporated or referred to in the tax compliance agreement, including the Covenants, may be changed and certain actions may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. Co-Bond Counsel expresses no opinion concerning any effect on the excludability of interest on the Bonds from gross income for federal income tax purposes of any such subsequent change or action that may be made, taken or omitted upon the advice or approval of counsel other than Co-Bond Counsel.

Certain Collateral Federal Tax Consequences

The following is a brief discussion of certain collateral federal income tax matters with respect to the Bonds. It does not purport to address all aspects of federal taxation that may be relevant to a particular owner thereof. Prospective purchasers of the Bonds, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the federal tax consequences of owning or disposing of the Bonds.

Prospective purchasers of the Bonds should be aware that the ownership of tax-exempt obligations may result in collateral federal income tax consequences to certain taxpayers including, without limitation, financial institutions, certain insurance companies, certain corporations (including S corporations and foreign corporations), certain foreign corporations subject to the "branch profits tax," individual recipients of Social Security or Railroad Retirement benefits, taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations and taxpayers attempting to qualify for the earned income tax credit.

In addition, prospective purchasers should be aware that the interest paid on, and the proceeds of the sale of, tax-exempt obligations, including the Bonds, are in many cases required to be reported to the IRS in a manner similar to interest paid on taxable obligations. Additionally, backup withholding may apply to any such payments to any Note owner who fails to provide an accurate Form W-9 Request for Taxpayer Identification Number and Certification, or a substantially identical form, or to any Note owner who is notified by the IRS of a failure to report all interest and dividends required to be shown on federal income tax returns. The reporting and withholding requirements do not in and of themselves affect the excludability of such interest from gross income for federal tax purposes or any other federal tax consequence of purchasing, holding or selling tax-exempt obligations.

Original Issue Discount

The "original issue discount" ("OID") on any note is the excess of such note's stated redemption price at maturity (excluding certain "qualified stated interest" that is unconditionally payable at least annually at prescribed rates) over the issue price of such

note. The "issue price" of a note is the initial offering price to the public at which price a substantial amount of such Bonds of the same maturity was sold. The "public" does not include bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers. The issue price for each maturity of the Bonds is expected to be the initial public offering price set forth on the inside front cover page of this Official Statement (or, in the case of Bonds sold on a yield basis, the initial offering price derived from such yield), but is subject to change based on actual sales. OID on the Bonds with OID (the "OID Bonds") represents interest that is excludable from gross income for purposes of federal income taxation. However, the portion of the OID that is deemed to have accrued to the owner of an OID Note in each year may be included in determining the alternative minimum tax and the distribution requirements of certain investment companies and may result in some of the collateral federal income tax consequences mentioned in the preceding subsection. Therefore, owners of OID Bonds should be aware that the accrual of OID in each year may result in alternative minimum tax liability, additional distribution requirements or other collateral federal income tax consequences although the owner may not have received cash in such year.

Interest in the form of OID is treated under Section 1288 of the Code as accruing under a constant yield method that takes into account compounding on a semiannual or more frequent basis. If an OID Note is sold or otherwise disposed of between semiannual compounding dates, then the OID which would have accrued for that semiannual compounding period for federal income tax purposes is to be apportioned in equal amounts among the days in such compounding period.

In the case of an original owner of an OID Note, the amount of OID that is treated as having accrued on such OID Note is added to the owner's cost basis in determining, for federal income tax purposes, gain or loss upon its disposition (including its sale, redemption or payment at maturity). The amounts received upon such disposition that are attributable to accrued OID will be excluded from the gross income of the recipients for federal income tax purposes. The accrual of OID and its effect on the redemption, sale or other disposition of OID Bonds that are not purchased in the initial offering at the initial offering price may be determined according to rules that differ from those described above.

Prospective purchasers of OID Bonds should consult their own tax advisors with respect to the precise determination for federal income tax purposes of interest accrued upon sale or redemption of such OID Bonds and with respect to state and local tax consequences of owning OID Bonds.

Bond Premium

In general, if an owner acquires a note for a purchase price (excluding accrued interest) or otherwise at a tax basis that reflects a premium over the sum of all amounts payable on the note after the acquisition date (excluding certain "qualified stated interest" that is unconditionally payable at least annually at prescribed rates), that premium constitutes "note premium" on that note (a "Premium Note"). In general, under Section 171 of the Code, an owner of a Premium Note must amortize the note premium over the remaining term of the Premium Note, based on the owner's yield over the remaining term of the Premium Note, determined based on constant yield principles. An owner of a Premium Note must amortize the note premium by offsetting the qualified stated interest allocable to each interest accrual period under the owner's regular method of accounting against the note premium allocable to that period. In the case of a tax-exempt Premium Note, if the note premium allocable to an accrual period exceeds the qualified stated interest allocable to that accrual period, the excess is a nondeductible loss. Under certain circumstances, the owner of a Premium Note may realize a taxable gain upon disposition of the Premium Note even though it is sold or redeemed for an amount less than or equal to the owner's original acquisition cost. Prospective purchasers of any Premium Bonds should consult their own tax advisors regarding the treatment of note premium for federal income tax purposes, including various special rules relating thereto, and state and local tax consequences, in connection with the acquisition, ownership, amortization of note premium on, sale, exchange, or other disposition of Premium Bonds.

Possible Legislative or Regulatory Action

Legislation and regulations affecting tax-exempt notes are continually being considered by the United States Congress, the United States Treasury Department (the "Treasury Department"), and the IRS. In addition, the IRS has established an expanded audit and enforcement program for tax-exempt notes. There can be no assurance that legislation enacted or proposed after the date of issue of the Bonds or an audit initiated or other enforcement or regulatory action taken by the Treasury or the IRS involving the Bonds or other tax-exempt notes will not have an adverse effect on the tax status or the market price of the Bonds or on the economic value of the tax-exempt status of the interest thereon.

QUALIFIED TAX-EXEMPT OBLIGATIONS

Section 265(a) of the Code provides, in general, that interest expense incurred to acquire or carry tax-exempt obligations is not deductible from the gross income of the holder. For certain holders that are "financial institutions" within the meaning of such section, complete disallowance of such expense would apply to taxable years beginning after December 31, 1986, with respect to tax-exempt obligations acquired after August 7, 1986. Section 265(b) of the Code provides an exception to this rule for interest expense incurred by financial institutions to carry tax-exempt obligations (other than certain private activity bonds) which are designated by an issuer as "qualified tax-exempt obligations." An issuer may only designate an issue as an issue of "qualified

tax-exempt obligations" where less than $10 million of tax-exempt obligations are issued by the issuer during the calendar year 2015.

The District has designated the Bonds as "qualified tax-exempt obligations." Further, the District represents that it has or will take such action necessary for the Bonds to constitute "qualified tax-exempt obligations."

Notwithstanding the designation of the Bonds as "qualified tax-exempt obligations," financial institutions acquiring the Bonds will be subject to a twenty percent (20%) disallowance of interest expenses allocable to the Bonds.

CONTINUING DISCLOSURE OF INFORMATION

In the Order, the District has made the following agreement for the benefit of the holders and beneficial owners of the Bonds. The District is required to observe the agreement for so long as it remains obligated to advance funds to pay the Bonds. Under the agreement, the District will be obligated to provide certain updated financial information and operating data annually, and timely notice of specified material events, to the Municipal Securities Rulemaking Board ("MSRB"). This information will be available free of charge from the MSRB via Electronic Municipal Market Access ("EMMA") system at www.emma.msrb.org. See "THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM" for a description of the continuing disclosure undertaking to provide certain updated financial information and operating data annually with respect to the Permanent School Fund and the State of Texas, as the case may be, and to provide timely notice of specified material events related to the guarantee to certain information vendors.

Annual Reports

The District will provide certain updated financial information and operating data to the MSRB annually in an electronic format as prescribed by the MSRB. The information to be updated includes all quantitative financial information and operating data with respect to the District of the general type included this Official Statement under Tables numbered 1 through 5 and 7 through 12, and in APPENDIX B. The District will update and provide this information within six months after the end of each fiscal year.

The District may provide updated information in full text or may incorporate by reference certain other publicly available documents, as permitted by SEC Rule 15c2-12 (the "Rule"). The updated information will include audited financial statements, if the District commissions an audit and it is completed by the required time. If audited financial statements are not available by the required time, the District will provide unaudited financial statements by the required time and audited financial statements when and if such audited financial statements become available. Any such financial statements will be prepared in accordance with the accounting principles described in APPENDIX B or such other accounting principles as the District may be required to employ from time to time pursuant to state law or regulation.

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

Material Event Notices

The District will also provide timely notices of certain events to the MSRB (not in excess of ten (10) days after the occurrence of the event). The District will provide notice of any of the following events with respect to the Bonds: (1) principal and interest payment delinquencies; (2) non-payment related defaults, if material; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the Bonds, or other material events affecting the tax status of the Bonds; (7) modifications to rights of holders of the Bonds, if material; (8) Bond calls, if material, and tender offers; (9) defeasances; (10) release, substitution, or sale of property securing repayment of the Bonds, if material; (11) rating changes; (12) bankruptcy, insolvency, receivership or similar event of the District; (13) the consummation of a merger, consolidation, or acquisition involving the District or the sale of all or substantially all of the assets of the District, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and (14) appointment of a successor or additional trustee or the change of name of a trustee, if material. (Neither the Bonds nor the Order make any provision for debt service reserves, redemption provisions, liquidity enhancement, or credit enhancement, except for the Permanent School Fund Guarantee). In addition, the District will provide timely notice of any failure by the District to provide information, data, or financial statements in accordance with its agreement described above under "Annual Reports".

All documents provided to the MSRB shall be accompanied by identifying information, as prescribed by the MSRB.

Limitations and Amendments

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

This continuing disclosure agreement may be amended by the District from time to time to adapt to changed circumstances that arise from a change in legal requirements, a change in law, or a change in the identity, nature, status, or type of operations of the District, but only if (1) the provisions, as so amended, would have permitted an underwriter to purchase or sell Bonds in the primary offering of the Bonds in compliance with the Rule, taking into account any amendments or interpretations of the Rule since such offering as well as such changed circumstances and (2) either (a) the registered owners of a majority in aggregate principal of the outstanding Bonds consent to such amendment or (b) a person that is unaffiliated with the District (such as nationally recognized bond counsel) determines that such amendment will not materially impair the interest of the registered owners and beneficial owners of the Bonds. The District may also amend or repeal the provisions of this continuing disclosure agreement if the SEC amends or repeals the applicable provision of the Rule or a court of final jurisdiction enters judgment that such provisions of the Rule are invalid, but only if and to the extent that the provisions of this sentence would not prevent an underwriter from lawfully purchasing or selling Bonds in the primary offering of the Bonds. If the District amends its agreement, it must include with the next financial information and opening data provided in accordance with its agreement described above under "Annual Reports" an explanation, in narrative form, of the reasons for the amendment and of the impact of any change in type of information and data provided. The District may also amend or repeal the provisions of this continuing disclosure agreement if the SEC amends or repeals the applicable provision of the Rule or a court of final jurisdiction enters judgment that such provisions of the Rule are invalid, but only if and to the extent that the provisions of this sentence would not prevent an underwriter from lawfully purchasing or selling Bonds in the primary offering of the Bonds.

Compliance with Prior Undertakings

Prior to this issuance of Bonds, the District has not entered into a continuing disclosure agreement pursuant to the Rule.

OTHER INFORMATION

Ratings

The District has received conditional approval for payment of the Bonds to be guaranteed by the Permanent School Fund of the State of Texas and Standard & Poor's Ratings Services, a Standard & Poor's Financial Services LLC business ("S&P") rates all bond issues (such as the Bonds) guaranteed by the Permanent School Fund of the State of Texas "AAA". See "THE PERMANENT SCHOOL FUND GUARANTEE PROGRAM" herein. An explanation of the significance of such ratings may be obtained from S&P. The ratings reflect only the views of S&P, and the District makes no representation as to the appropriateness of such ratings.

The above ratings are not recommendations to buy, sell, or hold the Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of either or both ratings may have an adverse effect on the market price of the Bonds.

No Litigation Certificate

The District is not a party to any litigation or other proceeding pending or to its knowledge, threatened, in any court, agency, or other administrative body (either state or federal) which, if decided adversely to the District, would have a material adverse effect on the financial statements or operations of the District. At the time of the initial delivery of the Bonds, the District will provide the Underwriters with a certificate to the effect that no litigation of any nature has been filed or is then pending challenging the issuance of the Bonds or that affects the payment and security of the Bonds or in any other manner questioning the issuance, sale, or delivery of said Bonds.

Legal Investments and Eligibility to Secure Public Funds in Texas

Under the Texas Public Security Procedures Act (Texas Government Code, Chapter 1201), the Bonds (1) are negotiable instruments, (2) are investment securities to which Chapter 8 of the Texas Uniform Commercial Code applies, and (3) are legal and authorized investments for (A) an insurance company, (B) a fiduciary or trustee, or (C) a sinking fund of a municipality or other political subdivision or public agency of the State of Texas. The Bonds are eligible to secure deposits of any public funds of the State, its agencies, and political subdivisions, and are legal security for those deposits to the extent of their market value. For political subdivisions in Texas which have adopted investment policies and guidelines in accordance with the Public Funds

Investment Act (Texas Government Code, Chapter 2256), the Bonds may have to be assigned a rating of "A" or its equivalent as to investment quality by a national rating agency before such Bonds are eligible investments for sinking funds and other public funds. In addition, various provisions of the Texas Finance Code provide that, subject to a prudent investor standard, the Bonds are legal investments for state banks, savings banks, trust companies with at least $1 million of capital and savings and loan associations.

The District has made no investigation of other laws, rules, regulations, or investment criteria which might apply to such institutions or entities or which might limit the suitability of the Bonds for any of the foregoing purposes or limit the authority of such institutions or entities to purchase or invest in the Bonds for such purposes. The District has made no review of laws in other states to determine whether the Bonds are legal investments for various institutions in those states.

Registration and Qualification of Bonds for Sale

No registration statement relating to the Bonds has been filed with the United States Securities and Exchange Commission under the federal Securities Act of 1933, as amended, in reliance upon the exemption provided thereunder by Section 3(a)(2); and the Bonds have not been registered or qualified under the Securities Act of Texas in reliance upon various exemptions contained therein; nor have the Bonds been registered or qualified under the securities acts of any other jurisdiction. The District assumes no responsibility for registration or qualification of the Bonds under the securities laws of any other jurisdiction in which the Bonds may be offered, sold, or otherwise transferred. This disclaimer of responsibility for registration and qualification for sale or other disposition of the Bonds shall not be construed as an interpretation of any kind with regard to the availability of any exemption from securities registration or qualification provisions in such other jurisdictions.

Legal Matters

The District will furnish a complete transcript of proceedings incident to the authorization and issuance of the Bonds, including the unqualified approving legal opinions of the Attorney General of the State of Texas to the effect that the Bonds are valid and legally binding obligations of the District, and based upon examination of such transcript of proceedings, the legal opinions of McGuireWoods LLP, Houston, Texas, and Powell & Leon LLP, Austin, Texas Co-Bond Counsel, with respect to the Bonds being issued in compliance with the provisions of applicable law and the interest on the Bonds being excludable from gross income for purposes of federal income tax. The form of Co-Bond Counsel's opinion is attached hereto as APPENDIX C – Form of Co-Bond Counsel's Opinion.

Co-Bond Counsel was engaged by, and only represents, the District. Except as noted below, Co-Bond Counsel did not take part in the preparation of the Official Statement, and such firm has not assumed any responsibility with respect thereto or undertaken independently to verify any of the information contained herein except that in its capacity as Co-Bond Counsel, such firm has reviewed the information appearing under captions or subcaptions, "THE BONDS" (except under the subcaptions "Sources and Uses of Funds", "Permanent School Fund Guarantee", and "Book-Entry Only System"), "STATE AND LOCAL FUNDING OF SCHOOL DISTRICTS IN TEXAS", "CURRENT PUBLIC SCHOOL FINANCE SYSTEM" (except under the subcaption "Possible Effects of Wealth Transfer Provisions on the District's Financial Condition"), "TAX RATE LIMITATIONS", "TAX MATTERS", "QUALIFIED TAX EXEMPT OBLIGATIONS", "CONTINUING DISCLOSURE OF INFORMATION" (except under the subcaption "Compliance With Prior Undertakings"), "OTHER INFORMATION – Legal Investments and Eligibility To Secure Public Funds in Texas", "OTHER INFORMATION – Registration and Qualification of Bonds For Sale", and "OTHER INFORMATION – Legal Matters" (except for the last two sentences of the second paragraph thereof) and such firm is of the opinion that the information relating to the Bonds and legal matters contained under such captions and subcaptions is an accurate and fair description of the laws and legal issues addressed therein and, with respect to the Bonds, such information conforms to the Order. The legal fee to be paid Co-Bond Counsel for services rendered in connection with the issuance of the Bonds is contingent upon the sale and delivery of the Bonds. The legal opinion of Co-Bond Counsel will accompany the Bonds deposited with DTC or will be printed on the definitive Bonds in the event of the discontinuance of the Book-Entry Only System. Certain legal matters will be passed upon for the Underwriters by their counsel, Andrews Kurth LLP, Houston, Texas. The legal fee of such firm is contingent upon the sale and delivery of the Bonds.

The various legal opinions to be delivered concurrently with the delivery of the Bonds express the professional judgment of the attorneys rendering the opinions as to the legal issues explicitly addressed therein. In rendering a legal opinion, the attorney does not become an insurer or guarantor of the expression of professional judgment, of the transaction opined upon, or of the future performance of the parties to the transaction. Nor does the rendering of an opinion guarantee the outcome of any legal dispute that may arise out of the transaction.

Financial Advisor

In its role as Financial Advisor, Government Capital Securities Corporation has relied on the District for certain information concerning the District and the Bonds. The fee of the Financial Advisor for services with respect to the Bonds is contingent upon the issuance and sale of the Bonds. The Financial Advisor is not obligated to undertake, and has not undertaken to make, an independent verification or to assume responsibility for the accuracy, completeness, or fairness of the information in this Official Statement.

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

Forward Looking Statements

The statements contained in this Official Statement, and in any other information provided by the District, that are not purely historical, are forward-looking statements, including statements regarding the District's expectations, hopes, intentions, or strategies regarding the future. Readers should not place undue reliance on forward-looking statements. All forward looking statements included in this Official Statement are based on information available to the District on the date hereof, and the District assumes no obligation to update any such forward-looking statements. It is important to note that the District's actual results could differ materially from those in such forward-looking statements.

The forward-looking statements herein are necessarily based on various assumptions and estimates and are inherently subject to various risks and uncertainties, including risks and uncertainties relating to the possible invalidity of the underlying assumptions and estimates and possible changes or developments in social, economic, business, industry, market, legal, and regulatory circumstances and conditions and actions taken or omitted to be taken by third parties, including customers, suppliers, business partners, and competitors, and legislative, judicial, and other governmental authorities and officials. Assumptions related to the foregoing involve judgments with respect to, among other things, future economic, competitive, and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the control of the District. Any of such assumptions could be inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this Official Statement would prove to be accurate.

Use of Audited Financial Statements

King, Moore, Truelove & Pharis, the District's independent auditor, has not been engaged to perform and has not performed, since the date of its report included herein, any procedures on the financial statements addressed in that report. King, Moore, Truelove & Pharis also has not performed any procedures relating to this Official Statement.

Underwriting

Raymond James & Company, Inc. and Coastal Securities, Inc. (the "Underwriters") have agreed to purchase the Bonds from the District for $4,098,196.12 (being the principal amount of the Bonds, plus a premium of $391,974.35, less an Underwriters' discount of $33,778.23).

The Underwriters have provided the following sentence for inclusion in this Official Statement. The Underwriters have reviewed the information set forth in this Official Statement in accordance with, and as part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

Miscellaneous

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

Concluding Statement

The information set forth herein has been obtained from the District's records, audited financial statements, and other sources which are considered to be reliable. There is no guarantee that any of assumptions or estimates contained herein will ever be realized. All of the summaries of the statutes, documents, and the Order contained in this Official Statement are made subject to all of the provisions of such statutes, documents, and the Order. These summaries do not purport to be complete statements of such provisions and reference is made to such summarized documents for further information. Reference is made to official

documents in all respects. The Order authorizing the issuance of the Bonds will also approve the form and content of this Official Statement and any addenda, supplement, or amendment thereto and authorize its further use in the re-offering of the Bonds by the Underwriters. This Official Statement has been approved by the Board of Trustees of the District for distribution in accordance with the provisions of the United States Securities and Exchange Commission's rule codified at 17 C.F.R. Section 240.15c2-12, as amended.

ATTEST:

/s/ Jennifer Trufan
Jennifer Trufan
Secretary, Board of Trustees
Chillicothe Independent School District

/s/ Mark Williams
Mark Williams
President, Board of Trustees
Chillicothe Independent School District

APPENDIX A

FINANCIAL INFORMATION REGARDING

CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

The Tax Code as it Applies to the District

The District grants a state mandated homestead exemption of $15,000 to all qualified residents. If the property owner qualifies for an over 65 or disabled person's exemption, the school district grants a state mandated exemption of an additional $10,000. A person eligible for both the over 65 and disabled person's exemption may receive only one.

The District grants a state mandated $15,000 general homestead exemption.

Ad valorem taxes are not levied by the District against the exempt value of residence homesteads for the payment of debt.

The District does not tax nonbusiness personal property and the District collects their own taxes.

The District does tax freeport property.

The District has not adopted a tax abatement policy.

Pursuant to the Texas Economic Development Act (Chapter 313, Texas Tax Code) and pursuant to its agreement with Blue Summit Wind, LLC ("Blue Summit"), the District has agreed to granted limitations on the appraised value (and providing ad valorem tax credits) upon the construction of certain qualifying investments of Blue Summit within the District for the period commencing with the 2015 tax year through and including the 2022 tax year. The District has agreed to limit the appraised property value for purposes of the District's ad valorem tax levy for maintenance and operations to an amount not to exceed $10,000,000 for such property. In return, Blue Summit has agreed to construct approximately $83.1 million of qualified investments in the District.

TABLE 1 - VALUATION, EXEMPTIONS, AND TAX SUPPORTED DEBT

District Direct Debt

2014 Certified Taxable Assessed Valuation (100% of Estimated Market Value)	$232,124,320
Outstanding Debt	0
Plus: The Bonds	3,740,000
Total Direct Debt	$ 3,740,000
As a % of 2014 Certified Taxable Assessed Valuation	1.61%

TABLE 2 - TAXABLE ASSESSED VALUATIONS BY CATEGORY

	Tax Year 2014	Tax Year 2013	Tax Year 2012	Tax Year 2011	Tax Year 2010
Real Property	$153,323,190	$149,952,710	$149,406,540	$150,544,070	
Mineral	208,098,990	212,286,020	96,089,130	85,958,530	
Gross Value	$361,422,180	$362,238,730	$245,495,670	$236,502,600	
Less Exemptions	129,297,850	121,989,176	120,636,670	122,559,890	
Net Taxable Value	$232,124,320	$240,249,554	$124,859,000	$113,942,710	$117,263,800[1]

[1] Breakdown for Tax Year 2010 is unavailable.

TABLE 3 - VALUATION AND TAX SUPPORTED DEBT HISTORY

Fiscal Year Ended 8/31	Estimated Population[1]	Taxable Assessed Valuation[2]	Taxable Assessed Valuation Per Capita	Tax Supported Debt Outstanding	Ratio of Tax Supported Debt to Assessed Valuation	Tax Supported Debt Per Capita
2011	1,185	$117,263,800	$ 98,957	$ 0	0.00%	$ 0
2012	1,097	113,942,710	103,868	0	0.00%	0
2013	1,262	124,859,000	98,937	0	0.00%	0
2014	1,234	240,249,554	194,692	0	0.00%	0
2015	1,280	232,124,320	181,347	3,740,000[3]	1.61%	2,922

(1) Source: The Municipal Advisory Council of Texas.
(2) As reported by the Hardeman County Appraisal District and Wilbarger County Appraisal District on the District's annual State Property Tax Reports and such values are subject to change during ensuing year.
(3) Includes the Bonds.

TABLE 4 - TAX RATE, LEVY, AND COLLECTION HISTORY

Fiscal Year Ended 8/31	Tax Year	Taxable Assessed Valuation[1]	Tax Rate	Tax Levy[2]	Percent Collected	
					Current	Total
2011	2010	$117,263,800	$1.0400	$1,219,544	96.00%	96.00%
2012	2011	113,942,710	1.0400	1,220,085	96.00%	96.00%
2013	2012	124,859,000	1.0400	1,175,987	96.00%	96.00%
2014	2013	240,249,554	1.0400	1,290,185	96.00%	96.00%
2015	2014	232,124,320	1.0400	2,412,839	96.00%	96.00%

(1) Net of exemptions. Assessed valuations do not include adjustments in supplemental rolls made after the end of each fiscal year.
(2) Excludes penalties and interest.

TABLE 5 - TEN LARGEST TAXPAYERS

Taxpayers	Type of Property	2014 Net Taxable Assessed Valuations	% of Total 2014 Assessed Valuation
1. Blue Summit Wind LLC	Wind Turbine	$103,340,020	44.52%
2. Mahard Egg Farm	Egg Farm	17,630,080	7.60%
3. Medallion Midstream LLC	Energy Service	10,795,210	4.65%
4. Kadane Corporation	Oil & Gas	8,855,010	3.81%
5. Electric Transmission of Texas	Transmission Lines	5,721,830	2.46%
6. BNSF Railway	Railway	5,392,110	2.32%
7. Electric Transmission of Texas	Transmission Lines	2,824,530	1.22%
8. Eagle Energy Acquisitions LP	Oil & Gas	2,374,780	1.02%
9. Fortson Oil Company	Oil & Gas	2,097,050	0.90%
10. AEP Texas North Company	Electric Utility	2,093,620	0.90%
Total		$161,124,240	69.40%

Table 6 - Estimated Overlapping Debt

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

Taxing Jurisdiction	As Of	Total Debt	Estimated % Overlapping	Overlapping Debt
Hardeman County	5/31/15	$ 725,000[(a)]	20.75%	$ 150,438
Wilbarger County	5/31/15	-None-	10.99%	0
Wilbarger County Hospital District	5/31/15	-None-	10.99%	0
Chillicothe, City of	5/31/15	-None-	100.00%	0
Chillicothe Hospital	5/31/15	-None-	100.00%	0
Estimated (Net) Overlapping Debt				$ 150,438
Chillicothe ISD[(b)]		$3,740,000		3,740,000
Total Direct & Estimated Overlapping Debt				$3,890,438
As a % of Certified 2014 Taxable Assessed Valuation				1.68%

[(a)] Gross Debt
[(b)] Includes the Bonds.

DEBT INFORMATION

TABLE 7 - TAX SUPPORTED DEBT SERVICE REQUIREMENTS

FISCAL YEAR ENDED 8/31	THE BONDS PRINCIPAL	THE BONDS INTEREST	TOTAL DEBT SERVICE
2015	$ 5,000.00	$ 5,591.67	$ 10,591.67
2016	180,000.00	134,100.00	314,100.00
2017	185,000.00	130,500.00	315,500.00
2018	190,000.00	126,800.00	316,800.00
2019	195,000.00	121,100.00	316,100.00
2020	205,000.00	115,250.00	320,250.00
2021	210,000.00	109,100.00	319,100.00
2022	215,000.00	102,800.00	317,800.00
2023	225,000.00	94,200.00	319,200.00
2024	230,000.00	85,200.00	315,200.00
2025	240,000.00	76,000.00	316,000.00
2026	250,000.00	66,400.00	316,400.00
2027	260,000.00	56,400.00	316,400.00
2028	270,000.00	46,000.00	316,000.00
2029	280,000.00	35,200.00	315,200.00
2030	295,000.00	24,000.00	319,000.00
2031	305,000.00	12,200.00	317,000.00
	$3,740,000.00	$1,340,841.67	$5,080,841.67

Estimated Average Annual Debt Service Requirements $298,873.04
Estimated Maximum Annual Debt Service Requirement $320,250.00

Table 8 - Authorized But Unissued Unlimited Tax Bonds

After the issuance of the Bonds, the District will have no authorized but unissued unlimited tax bonds. The District does not anticipate issuing additional debt this fiscal year.

Table 9 - Other Obligations

The District had no additional debt outstanding as of August 31, 2014.

Table 10 – Schedule of General Fund Revenues and Expenditure History

For Fiscal Year Ended August 31st

	2014	2013	2012	2011	2010
REVENUES:					
Total Local and Intermediate Sources	$ 2,681,028	$ 1,600,713	$ 1,390,887	$ 1,351,204	$ 1,186,021
State Program Revenues	669,992	524,398	787,134	943,153	805,994
Federal Program Revenues	-	-	7,717	9,608	46,875
Total Revenues	$ 3,351,020	$ 2,125,111	$ 2,185,738	$ 2,303,965	$ 2,038,890
EXPENDITURES:					
Current:					
Instruction	$ 1,265,536	$ 1,076,803	$ 996,351	$ 1,008,482	$ 1,059,137
Instructional Resources & Media Services	5,294	3,790	17,976	23,382	9,508
Curriculum & Instructional Staff Development	4,825	5,956	6,699	30,001	5,948
School Leadership	241,931	230,949	208,577	204,595	200,605
Guidance, Counseling & Evaluation Services	59,603	50,399	46,798	47,464	43,216
Health Services	1,438	1,297	2,590	3,509	1,446
Student (Pupil) Transportation	58,668	79,596	53,569	155,876	67,286
Food Service	2,787	2,314	2,278	2,391	2,499
Cocurricular/Extracurricular Activities	132,853	102,287	102,498	104,464	92,869
General Administration	329,589	292,286	298,233	254,180	288,774
Plant Maintenance and Operations	341,272	289,602	315,960	300,115	359,715
Security and Monitoring Services	2,314	3,124	3,010	-	2,244
Data Processing Services	942	4,056	4,056	4,200	-
Incremental Costs Related to WADA	-	-	-	-	3,473
Capital Outlay				28,928	-
Payments to Shared Service Arrangements	23,004	20,064	30,960	27,840	27,880
Other Intergovernmental Charges	40,123	25,887	21,958	21,055	17,719
Total Expenditures	$ 2,510,179	$ 2,188,410	$ 2,111,513	$ 2,216,482	$ 2,182,319
Excess (Deficiency) of Revenues Over (Under) Expenditures	840,841	(63,299)	74,225	87,483	(143,429)
OTHER FINANCING SOURCES (USES):					
Transfers In	-	207	7,200	-	-
Transfers Out	(16,900)	(7,200)	(16,325)	(148)	(13,112)
Total Other Financing Sources and (Uses)	(16,900)	(6,993)	(9,125)	(148)	(13,112)
Net Change in Fund Balances	823,941	(70,292)	65,100	87,335	(156,541)
Fund Balances – Beginning	1,966,310	2,036,602	1,971,503	1,884,168	2,040,709
Fund Balances – Ending	**$ 2,790,251**	**$ 1,966,310**	**$ 2,036,603**	**$ 1,971,503**	**$ 1,884,168**

Source: The District's audited financial statements.

TABLE 11 - GENERAL OPERATING FUND COMPARATIVE BALANCE SHEET [(a)]

	Fiscal Year Ended August 31st				
	2014	**2013**	**2012**	**2011**	**2010**
ASSETS					
Cash & Cash Equivalents	$ 83,605	$ 94,304	$ 132,934	$1,555,134	$1,684,014
Current Investments	2,701,764	2,077,619	1,926,170	-	-
Taxes Receivable, Net	72,253	78,959	102,839	137,431	149,838
Due from Other Governments	147,640	18,524	52,000	501,972	291,562
Total Assets	$3,005,262	$2,269,406	$2,213,943	$2,194,537	$2,125,414
LIABILITIES					
Current Liabilities:					
Accounts Payable	$ 35,104	$ 24,175	$ 20,487	$ 16,842	$ 24,882
Accrued Wages Payable	57,105	56,263	53,100	67,553	63,999
Due to Other Governments	49,556	142,138	-	-	720
Due to Student Groups	-	575	-	-	-
Accrued Expenditures	993	986	914	1,206	1,807
Unearned Revenue	78,959	78,959	102,839	137,431	149,838
Total Liabilities	142,758	303,096	177,340	223,034	$ 241,246
DEFERRED INFLOWS OF RESOURCES					
Unavailable Revenue – Property Taxes					
Total Deferred Inflows of Resources	72,253	-	-	-	-
	72,253	-	-	-	-
FUND BALANCES:					
Restricted Fund Balances:					
Federal/State Funds Grant Restrictions	-	-	-	-	-
Committed Fund Balances:					
Construction	590,500	590,500	590,500	590,500	1,500,000
Capital Expenditures for Equipment	122,407	122,407	122,407	122,407	-
Other Committed Fund Balance	692,093	692,093	692,093	692,093	-
Unassigned	1,385,251	561,310	631,603	566,503	384,168
Total Fund Balances	$2,790,251	$1,966,310	$2,036,603	$1,971,503	$1,884,168
Total Liabilities and Fund Balances	$3,005,262	$2,269,406	$2,213,943	$2,194,537	$2,125,414

[(a)] Source: District's audited financial reports. See "Appendix B – EXCERPTS FROM THE CHILLICOTHE INDEPENDENT SCHOOL DISTRICT ANNUAL FINANCIAL REPORT".

TABLE 12 - CURRENT INVESTMENTS

As of May 1, 2015, the District's investable funds amounted to $3,712,802. The following summary itemizes the District's investment portfolio by type of security:

	Percent	Book Value	Market Value
Cash & Cash Equivalents	3.82%	$ 141,923	$ 141,923
Certificates of Deposit	96.04%	$ 3,565,614	$ 3,565,614
Lone Star Investment Pool[(1)]	0.14%	$ 5,265	$ 5,265
Total	100.00%	$ 3,712,802	$ 3,712,802

[(1)] The investment pools in which the District invests were created for Texas governmental entities. Such investment pools operate as money-market equivalents.

No funds of the District are invested in derivative securities, i.e., securities whose rate of return is determined by reference to another instrument, index, or commodity.

CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

ANNUAL FINANCIAL REPORT

FOR THE YEAR ENDED AUGUST 31, 2014

Chillicothe Independent School District
Annual Financial Report
For The Year Ended August 31, 2014

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Introductory Section

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CERTIFICATE OF BOARD

Chillicothe Independent School District	Hardeman	099-902
Name of School District	County	Co.-Dist. Number

We, the undersigned, certify that the attached annual financial reports of the above named school district were reviewed and (check one) ✓ approved _____ disapproved for the year ended August 31, 2014, at a meeting of the board of trustees of such school district on the 2 day of December 2014

Jennifer Jinson
Signature of Board Secretary

Signature of Board President

If the board of trustees disapproved of the auditor's report, the reason(s) for disapproving it is (are):
(attach list as necessary)

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Financial Section

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KING, MOORE, TRUELOVE & PHARIS

Certified Public Accountants
Michael C. Moore, *CPA*
John T. Truelove, *CPA*
Douglas A. Pharis, *CPA*

Independent Auditor's Report

To the Board of Trustees
Chillicothe Independent School District
Chillicothe, Texas

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Chillicothe Independent School District ("the District") as of and for the year ended August 31, 2014, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the District's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of Chillicothe Independent School District as of August 31, 2014, and the respective changes in financial position, for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

Change in Accounting Principle

As described in Note A to the financial statements, in 2014, Chillicothe Independent School District adopted

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new accounting guidance, Government Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities.* Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and budgetary comparison information identified as Required Supplementary Information in the table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the Required Supplementary Information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

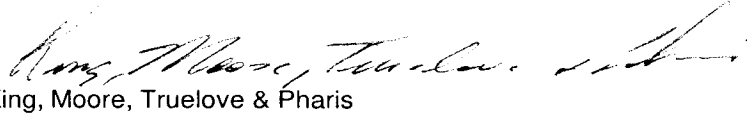
Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Chillicothe Independent School District's basic financial statements. The introductory section and individual nonmajor fund financial statements are presented for purposes of additional analysis and are not required parts of the basic financial statements. The accompanying other supplementary information is presented for purposes of additional analysis and is also not a required part of the basic financial statements.

The individual nonmajor fund financial statements and other supplementary information are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the individual nonmajor fund financial statements and other supplementary information are fairly stated in all material respects in relation to the basic financial statements as a whole.

The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 18, 2014 on our consideration of Chillicothe Independent School District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Chillicothe Independent School District's internal control over financial reporting and compliance.



King, Moore, Truelove & Pharis

Vernon, TX
November 18, 2014

Management's Discussion and Analysis

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MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of Chillicothe Independent School District's annual financial report presents our discussion and analysis of the District's financial performance during the fiscal year ended August 31, 2014. Please read it in conjunction with the District's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

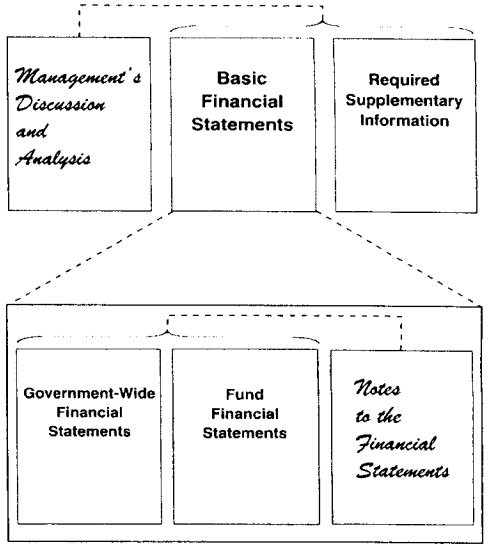
- The District's total combined net position was $4,005,859 at August 31, 2014.
- During the year, the District's expenses were $777,295 less than the $3,609,750 generated in taxes and other revenues for governmental activities.
- The total cost of the District's programs increased $317,586 from last year.
- The general fund reported a fund balance this year of $2,790,251.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of three parts—*management's discussion and analysis* (this section), the *basic financial statements, and required supplementary information.* The basic financial statements include two kinds of statements that present different views of the District:

- The first two statements are *government-wide financial statements* that provide both *long-term* and *short-term* information about the District's overall financial status.
- The remaining statements are *fund financial statements* that focus on *individual parts* of the government, reporting the District's operations in more detail than the government-wide statements.
- *The governmental funds* statements tell how *general government* services were financed in the *short term* as well as what remains for future spending.
- *Fiduciary fund* statements provide information about the financial relationships in which the District acts solely as a *trustee or agent* for the benefit of others, to whom the resources in question belong.

Figure A-1, Required Components of the District's Annual Financial Report



The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of *required supplementary information* that further explains and supports the information in the financial statements. Figure A-1 shows how the required parts of this annual report are arranged and related to one another.

Figure A-2 summarizes the major features of the District's financial statements, including the portion of the District government they cover and the types of information they contain. The remainder of this overview section of management's discussion and analysis explains the structure and contents of each of the statements.

Figure A-2. Major Features of the District's Government-wide and Fund Financial Statements

		Fund Statements		
Type of Statements	**Government-wide**	**Governmental Funds**	**Proprietary Funds**	**Fiduciary Funds**
Scope	Entire Agency's government (except fiduciary funds) and the Agency's component units	The activities of the district that are not proprietary or fiduciary	Activities the district operates similar to private businesses: self insurance	Instances in which the district is the trustee or agent for someone else's resources
Required financial statements	* Statement of net position * Statement of activities	* Balance sheet * Statement of revenues, expenditures & changes in fund balances	* Statement of net position * Statement of revenues, expenses and changes in fund net assets * Statement of cash flows	* Statement of fiduciary net position * Statement of changes in fiduciary net position
Accounting basis and measurement focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus	Accrual accounting and economic resources focus
Type of asset/liability information	All assets and liabilities, both financial and capital, short-term and long-term	Only assets expected to be used up and liabilities that come due during the year or soon thereafter; no capital assets included	All assets and liabilities, both financial and capital, and short-term and long-term	All assets and liabilities, both short-term and long-term; the Agency's funds do not currently contain capital assets, although they can
Type of inflow/outflow information	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year; expenditures when goods or services have been received and payment is due during the year or soon thereafter	All revenues and expenses during year, regardless of when cash is received or paid	All revenues and expenses during year, regardless of when cash is received or paid

Government-wide Statements

The government-wide statements report information about the District as a whole using accounting methods similar to those used by private-sector companies. The statement of net position includes all of the government's assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two government-wide statements report the District's net position and how they have changed. Net position—the difference between the District's assets and liabilities—is one way to measure the District's financial health or *position*.

- Over time, increases or decreases in the District's net position is an indicator of whether its financial health is improving or deteriorating, respectively.

- To assess the overall health of the District, one needs to consider additional nonfinancial factors such as changes in the District's tax base.

The government-wide financial statements of the District include the *Governmental activities*. Most of the District's basic services are included here, such as instruction, extracurricular activities, curriculum and staff development, health services and general administration. Property taxes and grants finance most of these activities.

Fund Financial Statements

The fund financial statements provide more detailed information about the District's most significant *funds*—not the District as a whole. Funds are accounting devices that the District uses to keep track of specific sources of funding and spending for particular purposes.

- Some funds are required by State law and by bond covenants.

- The Board of Trustees establishes other funds to control and manage money for particular purposes or to show that it is properly using certain taxes and grants.

The District has the following kinds of funds:

- *Governmental funds*—Most of the District's basic services are included in governmental funds, which focus on (1) how *cash and other financial assets* that can readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental fund statements provide a detailed *short-term* view that helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the District's programs. Because this information does not encompass the additional long-term focus of the government-wide statements, we provide additional information at the bottom of the governmental funds statement, or on the subsequent page, that explain the relationship (or differences) between them.

- *Fiduciary funds*—The District is the trustee, or *fiduciary*, for certain funds. It is also responsible for other assets that—because of a trust arrangement—can be used only for the trust beneficiaries. The District is responsible for ensuring that the assets reported in these funds are used for their intended purposes. All of the District's fiduciary activities are reported in a separate statement of fiduciary net position and a statement of changes in fiduciary net position. We exclude these activities from the District's government-wide financial statements because the District cannot use these assets to finance its operations.

FINANCIAL ANALYSIS OF THE DISTRICT AS A WHOLE

Net position. The District's combined net position was $4,005,859 at August 31, 2014. (See Table A-1)

Table A-1
Chillicothe Independent School District's Combined Net Position

	Governmental Activities		Total Percentage Change
	2014	2013	2013-2014
ASSETS:			
Cash and Cash Equivalents	$ 87,094	$ 106,677	-18.4%
Investments	2,701,764	2,077,619	30.0%
Property Taxes Receivable (Net)	72,253	78,959	-8.5%
Due from Other Governments	168,088	25,149	568.4%
Capital Assets:			
Land	53,122	53,122	-
Buildings, Furniture, and Equipment, Net	1,075,648	1,120,354	-4.0%
Total Assets	4,157,969	3,461,880	20.1%
LIABILITIES:			
Accounts Payable	39,435	28,082	40.4%
Accrued Liabilities	63,119	62,342	1.2%
Due to Other Governments	49,556	142,317	-65.2%
Due to Student Groups	-	575	-100.0%
Total Liabilities	152,110	233,316	-34.8%
NET POSITION			
Invested in Capital Assets, Net of Related Debt	1,128,770	1,173,476	-3.8%
Restricted	14,585	9,819	48.5%
Unrestricted	2,862,504	2,045,269	40.0%
Total Net Position	$ 4,005,859	$ 3,228,564	24.1%

Changes in net position. The District's total revenues were $3,609,750. A significant portion, 69%, of the District's revenue comes from taxes. (See Figure A-3.) 9% comes from operating grants and contributions, while 1% relates to charges for services.

The total cost of all programs and services was $2,832,455; 49% of these costs are for instructional services.

Governmental Activities

- Property tax rate was $1.04 per $100 valuation. This tax rate coupled with increasing property values, from the wind farm generators, resulted in an increase in tax revenues of $1,126,401.

Figure A-3 District
Sources of Revenue for Fiscal Year 2014

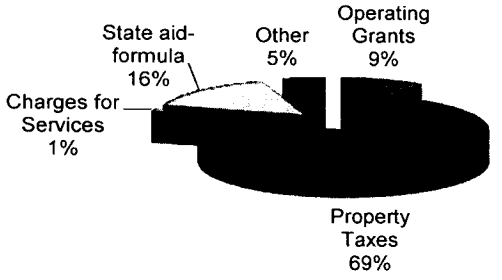


Table A-2
Changes in Chillicothe Independent School District's Net Position

	Governmental Activities		Total Percentage Change
	2014	2013	2013-2014
Program Revenues:			
Charges for Services	$ 30,426	$ 32,924	-7.6%
Operating Grants and Contributions	339,562	409,890	-17.2%
Capital Grants and Contributions	-	-	-
General Revenues			
Property Taxes	2,495,330	1,368,929	82.3%
State Aid – Formula	573,809	439,368	30.6%
Investment Earnings	18,643	24,316	-23.3%
Other	151,980	66,934	127.1%
Total Revenues	3,609,750	2,342,361	54.1%
Instruction	1,386,379	1,218,225	13.8%
Instructional Resources and Media Services	14,434	18,667	-22.7%
Curriculum Dev. And Instructional Staff Dev.	5,016	6,239	-19.6%
School Leadership	251,802	231,320	8.9%
Guidance, Counseling and Evaluation Services	61,959	52,802	17.3%
Health Services	1,495	1,391	7.5%
Student (Pupil) Transportation	85,067	73,721	15.4%
Food Services	175,757	149,643	17.5%
Curricular/Extracurricular Activities	114,338	107,187	6.7%
General Administration	342,618	306,272	11.9%

Plant Maintenance & Oper.	326,465	295,644	10.4%
Security & Monitoring Svcs.	3,019	3,563	-15.3%
Data Processing Services	979	4,244	-76.9%
Payments Related Shared Services Arrangements	23,004	20,064	14.7%
Other Intergovernmental Charges	40,123	25,887	55.0%
Total Expenses	2,832,455	2,514,869	12.6%
Excess (Deficiency) Before Other Resources, Uses & Transfers	777,295	(172,508)	550.6%
Other Resources (Uses)	-	-	-
Transfers In (Out)	-	-	-
Increase (Decrease) in Net Position	$ 777,295	$ (172,508)	550.6%

Table A-3 presents the cost of each of the District's largest functions as well as each function's net cost (total cost less fees generated by the activities and intergovernmental aid). The net cost reflects the amount that was funded by state revenues as well as local tax dollars.

- The cost of all governmental activities this year was $2,832,455.
- However, the amount that our taxpayers paid for these activities through property taxes was $2,495,330.
- Some of the cost was paid by those who directly benefited from the programs $30,426, or
- By grants and contributions $339,562.

Table A-3

Net Cost of Selected District Functions

	Total Cost of Services		% Change	Net Cost of Services		% Change
	2014	2013		2014	2013	
Instruction	$ 1,386,379	$ 1,218,225	13.8%	$ 1,237,552	$ 1,031,565	20.0%
School leadership	$ 251,802	$ 231,320	8.9%	$ 241,917	$ 209,969	15.2%
General administration	$ 342,618	$ 306,272	11.9%	$ 329,553	$ 279,526	17.9%
Plant Maintenance & Operations	$ 326,465	$ 295,644	10.4%	$ 311,316	$ 267,943	16.2%

FINANCIAL ANALYSIS OF THE DISTRICT'S FUNDS

Revenues from governmental fund types totaled $3,616,456, an increase of 52% over the preceding year.

General Fund Budgetary Highlights

Over the course of the year, the District revised its budget. With these adjustments, actual general fund expenditures were $128,687 below final budget amounts.

Resources available were $62,147 above the final budgeted amount.

- Local and Intermediate Source revenue was above budget amounts for the current year.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At the end of 2014, the District had invested $4,101,389 in a broad range of capital assets, including land, equipment, buildings, and vehicles. (See Table A-4.) This amount represents a net increase (including additions and deductions) of $83,758.

Table A-4

District's Capital Assets

	Governmental Activities	
	2014	2013
Land	$ 53,122	$ 53,122
Buildings and improvements	3,164,886	3,134,107
Vehicles	646,197	646,197
Equipment	237,184	184,205
Totals at historical cost	4,101,389	4,017,631
Total accumulated depreciation	2,972,619	2,844,155
Net capital assets	$ 1,128,770	$ 1,173,476

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

- Appraised value used for the 2014-2015 budget preparation did not change significantly from the prior year. The District tax collections are budgeted to be approximately the same as 2013-2014.

- The District's 2014-2015 refined average daily attendance is not expected to change materially, however due to the 2013-2014 increase in appraised values and property tax collections, as the result of the wind farm becoming operational, the District's State Foundation revenue is expecting to dramatically decline and the District budgeted a $560,000 refund to the state as a result of becoming a Chapter 41 District.

These indicators were taken into account when adopting the general fund budget for 2014-2015. Amounts available for appropriation in the general fund budget are $2,767,737, a decrease of 17 percent over the final 2013-2014 actual revenues of $3,351,020. The District will use these revenues to finance programs we currently offer.

Expenditures are budgeted to increase 18 percent, over the final 2013-2014 actual expenditures of $2,510,179, to $2,952,711. The District has added no major new programs or initiatives to the 2014-2015 budget.

If these estimates are realized, the District's budgetary general fund balance is expected to decrease by $184,974 by the close of the 2014-2015 school year.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's Superintendent.

Basic Financial Statements

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CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

STATEMENT OF NET POSITION
AUGUST 31, 2014

Data Control Codes		1 Governmental Activities
	ASSETS:	
1110	Cash and Cash Equivalents	$ 87,094
1120	Current Investments	2,701,764
1225	Property Taxes Receivable (Net)	72,253
1240	Due from Other Governments	168,088
	Capital Assets:	
1510	Land	53,122
1520	Buildings and Improvements, Net	879,879
1530	Furniture and Equipment, Net	195,769
1000	Total Assets	4,157,969
	LIABILITIES:	
2110	Accounts Payable	39,435
2165	Accrued Liabilities	63,119
2180	Due to Other Governments	49,556
2000	Total Liabilities	152,110
	NET POSITION:	
3200	Net Investment in Capital Assets	1,128,770
	Restricted For:	
3820	State and Federal Programs	14,585
3900	Unrestricted	2,862,504
3000	Total Net Position	$ 4,005,859

The accompanying notes are an integral part of this statement.

CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED AUGUST 31, 2014

Data Control Codes	Functions/Programs	1 Expenses	3 Program Revenues: Charges for Services	4 Program Revenues: Operating Grants and Contributions	Net (Expense) Revenue and Changes in Net Position: Governmental Activities
	Governmental Activities:				
11	Instruction	$ 1,386,379	$ --	$ 148,827	$ (1,237,552)
12	Instructional Resources and Media Services	14,434	--	8,787	(5,647)
13	Curriculum and Staff Development	5,016	--	191	(4,825)
23	School Leadership	251,802	--	9,885	(241,917)
31	Guidance, Counseling, & Evaluation Services	61,959	--	2,363	(59,596)
33	Health Services	1,495	--	57	(1,438)
34	Student Transportation	85,067	--	2,326	(82,741)
35	Food Service	175,757	19,447	132,921	(23,389)
36	Cocurricular/Extracurricular Activities	114,338	10,979	4,360	(98,999)
41	General Administration	342,618	--	13,065	(329,553)
51	Facilities Maintenance and Operations	326,465	--	15,149	(311,316)
52	Security and Monitoring Services	3,019	--	682	(2,337)
53	Data Processing Services	979	--	37	(942)
93	Payments Related to Shared Services Arrangements	23,004	--	912	(22,092)
99	Other Intergovernmental Charges	40,123	--	--	(40,123)
TG	Total Governmental Activities	2,832,455	30,426	339,562	(2,462,467)
TP	Total Primary Government	$ 2,832,455	$ 30,426	$ 339,562	(2,462,467)
	General Revenues:				
MT	Property Taxes, Levied for General Purposes				2,495,330
IE	Investment Earnings				18,643
GC	Grants and Contributions Not Restricted to Specific Programs				573,809
MI	Miscellaneous				151,980
TR	Total General Revenues				3,239,762
CN	Change in Net Position				777,295
NB	Net Position - Beginning				3,228,564
NE	Net Position - Ending				$ 4,005,859

The accompanying notes are an integral part of this statement.

CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

BALANCE SHEET - GOVERNMENTAL FUNDS
AUGUST 31, 2014

Data Control Codes		10 General Fund	Other Governmental Funds	98 Total Governmental Funds
	ASSETS:			
1110	Cash and Cash Equivalents	$ 83,605	$ 3,489	$ 87,094
1120	Current Investments	2,701,764	--	2,701,764
1225	Taxes Receivable, Net	72,253	--	72,253
1240	Due from Other Governments	147,640	20,448	168,088
1000	Total Assets	$ 3,005,262	$ 23,937	$ 3,029,199
	LIABILITIES:			
	Current Liabilities:			
2110	Accounts Payable	$ 35,104	$ 4,331	$ 39,435
2160	Accrued Wages Payable	57,105	4,721	61,826
2180	Due to Other Governments	49,556	--	49,556
2200	Accrued Expenditures	993	300	1,293
2000	Total Liabilities	142,758	9,352	152,110
	DEFERRED INFLOWS OF RESOURCES:			
	Unavailable Revenue - Property Taxes	72,253	--	72,253
2600	Total Deferred Inflows of Resources	72,253	--	72,253
	FUND BALANCES:			
	Restricted Fund Balances:			
3450	Federal/State Funds Grant Restrictions	--	14,585	14,585
	Committed Fund Balances:			
3510	Construction	590,500	--	590,500
3530	Capital Expenditures for Equipment	122,407	--	122,407
3545	Other Committed Fund Balance	692,093	--	692,093
3600	Unassigned	1,385,251	--	1,385,251
3000	Total Fund Balances	2,790,251	14,585	2,804,836
4000	Total Liabilities, Deferred Inflow of Resources and Fund Balances	$ 3,005,262	$ 23,937	$ 3,029,199

The accompanying notes are an integral part of this statement.

CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET POSITION
AUGUST 31, 2014

Total fund balances - governmental funds balance sheet	$	2,804,836
Amounts reported for governmental activities in the Statement of Net Position are different because:		
Capital assets used in governmental activities are not reported in the funds.		1,128,770
Property taxes receivable unavailable to pay for current period expenditures are deferred in the funds.		72,253
Net position of governmental activities - Statement of Net Position	$	4,005,859

The accompanying notes are an integral part of this statement.

CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES - GOVERNMENTAL FUNDS
FOR THE YEAR ENDED AUGUST 31, 2014

Data Control Codes		10 General Fund	Other Governmental Funds	98 Total Governmental Funds
	REVENUES:			
5700	Local and Intermediate Sources	$ 2,681,028	$ 22,057	$ 2,703,085
5800	State Program Revenues	669,992	28,932	698,924
5900	Federal Program Revenues	--	214,447	214,447
5020	Total Revenues	3,351,020	265,436	3,616,456
	EXPENDITURES:			
	Current:			
0011	Instruction	1,265,536	98,265	1,363,801
0012	Instructional Resources and Media Services	5,294	8,577	13,871
0013	Curriculum and Staff Development	4,825	--	4,825
0023	School Leadership	241,931	295	242,226
0031	Guidance, Counseling, & Evaluation Services	59,603	--	59,603
0033	Health Services	1,438	--	1,438
0034	Student Transportation	58,668	--	58,668
0035	Food Service	2,787	166,286	169,073
0036	Cocurricular/Extracurricular Activities	132,853	--	132,853
0041	General Administration	329,589	--	329,589
0051	Facilities Maintenance and Operations	341,272	3,557	344,829
0052	Security and Monitoring Services	2,314	590	2,904
0053	Data Processing Services	942	--	942
0093	Payments to Shared Service Arrangements	23,004	--	23,004
0099	Other Intergovernmental Charges	40,123	--	40,123
6030	Total Expenditures	2,510,179	277,570	2,787,749
1100	Excess (Deficiency) of Revenues Over (Under)			
1100	Expenditures	840,841	(12,134)	828,707
	Other Financing Sources and (Uses):			
7915	Transfers In	--	16,900	16,900
8911	Transfers Out	(16,900)	--	(16,900)
7080	Total Other Financing Sources and (Uses)	(16,900)	16,900	--
1200	Net Change in Fund Balances	823,941	4,766	828,707
0100	Fund Balances - Beginning	1,966,310	9,819	1,976,129
3000	Fund Balances - Ending	$ 2,790,251	$ 14,585	$ 2,804,836

The accompanying notes are an integral part of this statement.

CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED AUGUST 31, 2014

Net change in fund balances - total governmental funds	$	828,707
Amounts reported for governmental activities in the Statement of Activities ("SOA") are different because:		
Capital outlays are not reported as expenses in the SOA.		83,758
The depreciation of capital assets used in governmental activities is not reported in the funds.		(128,464)
Certain property tax revenues are deferred in the funds. This is the change in these amounts this year.		(6,706)
Change in net position of governmental activities - Statement of Activities	$	777,295

The accompanying notes are an integral part of this statement.

CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

STATEMENT OF FIDUCIARY NET POSITION
FIDUCIARY FUNDS
AUGUST 31, 2014

Data Control Codes		Private-purpose Trust Funds	Agency Funds Student Activity
	ASSETS:		
1110	Cash and Cash Equivalents	$ --	$ 31,716
1800	Restricted Assets	33,372	--
1000	Total Assets	33,372	31,716
	LIABILITIES:		
	Current Liabilities:		
2190	Due to Student Groups	--	31,716
2000	Total Liabilities	--	31,716
	NET POSITION:		
3800	Held in Trust	33,372	--
3000	Total Net Position	$ 33,372	$ --

The accompanying notes are an integral part of this statement.

CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

STATEMENT OF CHANGES IN FIDUCIARY NET POSITION
FIDUCIARY FUNDS
FOR THE YEAR ENDED AUGUST 31, 2014

	Private-Purpose Trusts
Additions:	
Investment Income	$ 260
Contributions	590
Total Additions	850
Deductions:	
Scholarship Awards	1,600
Total Deductions	1,600
Change in Net Position	(750)
Net Position-Beginning of the Year	34,122
Net Position-End of the Year	$ 33,372

The accompanying notes are an integral part of this statement.

A. Summary of Significant Accounting Policies

The basic financial statements of Chillicothe Independent School District (the "District") have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") applicable to governmental units in conjunction with the Texas Education Agency's Financial Accountability System Resource Guide ("Resource Guide"). The Governmental Accounting Standards Board ("GASB") is the accepted standard setting body for establishing governmental accounting and financial reporting principles.

1. Reporting Entity

The Board of School Trustees ("Board"), a seven-member group, has governance responsibilities over all activities related to public elementary and secondary education within the jurisdiction of the District. The Board is elected by the public and has the exclusive power and duty to govern and oversee the management of the public schools of the District. All powers and duties not specifically delegated by statute to the Texas Education Agency ("TEA") or to the State Board of Education are reserved for the Board, and the TEA may not substitute its judgment for the lawful exercise of those powers and duties by the Board. The District receives funding from local, state and federal government sources and must comply with the requirements of those funding entities. However, the District is not included in any other governmental "reporting entity" as defined by the GASB in its Statement No. 14, "The Financial Reporting Entity," as revised by GASB Statement No. 39, and there are no component units included within the reporting entity.

2. Basis of Presentation, Basis of Accounting

a. Basis of Presentation

Government-wide Financial Statements: The statement of net position and the statement of activities include the financial activities of the overall government, except for fiduciary activities. Eliminations have been made to minimize the double-counting of internal activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange transactions.

The statement of activities presents a comparison between direct expenses and program revenues for each function of the District's governmental activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. The District does not allocate indirect expenses in the statement of activities. Program revenues include (a) fees, fines, and charges paid by the recipients of goods or services offered by the programs and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

Fund Financial Statements: The fund financial statements provide information about the District's funds, with separate statements presented for each fund category. The emphasis of fund financial statements is on major governmental funds, each displayed in a separate column. All remaining governmental funds are aggregated and reported as nonmajor funds.

Proprietary fund operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities.

The District reports the following major governmental funds:

General Fund: This is the District's primary operating fund. It accounts for all financial resources of the District except those required to be accounted for in another fund.

In addition, the District reports the following fund types:

Special Revenue Funds: The District accounts for activities funded with restricted or committed revenues in special revenue funds. Most federal and state grant programs are accounted for in these funds, as well as the District's campus activity funds.

Private-Purpose Trust Funds: These funds are used to report trust arrangements under which principal and income benefit individuals, private organizations, or other governments not reported in other fiduciary fund types.

Agency Funds: These funds are used to report student activity funds and other resources held in a purely custodial capacity (assets equal liabilities). Agency funds typically involve only the receipt, temporary investment, and remittance of fiduciary resources to individuals, private organizations, or other governments.

Fiduciary funds are reported in the fiduciary fund financial statements. However, because their assets are held in a trustee or agent capacity and are therefore not available to support District programs, these funds are not included in the government-wide statements.

b. Measurement Focus, Basis of Accounting

Government-wide, Proprietary, and Fiduciary Fund Financial Statements: These financial statements are reported using the economic resources measurement focus. The government-wide and proprietary fund financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Nonexchange transactions, in which the District gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes, grants, entitlements, and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied.

Governmental Fund Financial Statements: Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. The District does not consider revenues collected after its year-end to be available in the current period. Revenues from local sources consist primarily of property taxes. Property tax revenues and revenues received from the State are recognized under the susceptible-to-accrual concept. Miscellaneous revenues are recorded as revenue when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures to the extent they have matured. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

When the District incurs an expenditure or expense for which both restricted and unrestricted resources may be used, it is the District's policy to use restricted resources first, then unrestricted resources.

3. Financial Statement Amounts

a. Cash and Cash Equivalents

For purposes of the statement of cash flows, highly liquid investments are considered to be cash equivalents if they have a maturity of three months or less when purchased.

b. Property Taxes

Property taxes are levied by October 1 on the assessed value listed as of the prior January 1, for all real and business personal property in conformity with Subtitle E of the Texas Property Tax Code. Taxes are due on receipt of the tax bill and are delinquent if not paid before February 1 of the year following the year in which imposed. On January 1 of each year, a tax lien attaches to property to secure the payment of all taxes, penalties, and interest ultimately imposed. Property tax revenues are considered available when they become due or past due and receivable within the current period.

Allowances for uncollectible tax receivables within the General Fund are based upon historical experience in collecting property taxes. Uncollectible personal property taxes are periodically reviewed and written off, but the District is prohibited from writing off real property taxes without specific statutory authority from the Texas Legislature.

Net property tax receivable is calculated as follows:

Gross property taxes receivable	$	120,422
Allowance for uncollectible taxes		(48,169)
Net property taxes receivable	$	72,253

c. Inventories and Prepaid Items

The District records purchases of supplies as expenditures, utilizing the purchase method of accounting for inventory in accordance with the Resource Guide,

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items.

d. Capital Assets

Purchased or constructed capital assets are reported at cost or estimated historical cost. Donated fixed assets are recorded at their estimated fair value at the date of the donation. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized. A capitalization threshold of $5,000 is used.

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

Asset Class	Estimated Useful Lives
Buildings	20-50
Building Improvements	10-50
Vehicles	2-15
Office Equipment	3-15
Computer Equipment	3-15

e. Receivable and Payable Balances

The District believes that sufficient detail of receivable and payable balances is provided in the financial statements to avoid the obscuring of significant components by aggregation. Therefore, no disclosure is provided which disaggregates those balances.

There are no significant receivables, with the exception of delinquent property taxes, which are not scheduled for collection within one year of year end.

f. Interfund Activity

Interfund activity results from loans, services provided, reimbursements or transfers between funds. Loans are reported as interfund receivables and payables as appropriate and are subject to elimination upon consolidation. Services provided, deemed to be at market or near market rates, are treated as revenues and expenditures or expenses. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers In and Transfers Out are netted and presented as a single "Transfers" line on the government-wide statement of activities. Similarly, interfund receivables and payables are netted and presented as a single "Internal Balances" line of the government-wide statement of net assets.

g. Use of Estimates

The preparation of financial statements in conformity with GAAP requires the use of management's estimates.

The amount of foundation revenues a school district earns for a year can and does vary until the time when final values for each of these factors in the formula become available. Availability can be as late as midway into the next fiscal year. It is reasonably possible that foundation revenue estimates as of this fiscal year end will change.

h. Data Control Codes

Data Control Codes appear in the rows and above the columns of certain financial statements. The TEA requires the display of these codes in the financial statements filed with TEA in order to insure accuracy in building a statewide database for policy development and funding plans.

i. Deferred Outflows/Inflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (*expense/expenditure*) until then. For the year ended August 31, 2014, the District has no type of item that qualifies for reporting in this category.

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The District has only one type of item that qualities for reporting in this category, property taxes receivable. Property taxes receivable are unavailable and therefore cannot be recognized as revenue in the governmental funds until they are received.

j. Fund Balances - Governmental Funds

Fund balances of the governmental funds are classified as follows:

Nonspendable Fund Balance - represents amounts that cannot be spent because they are either not in spendable form (such as inventory or prepaid insurance) or legally required to remain intact (such as notes receivable or principal of a permanent fund).

Restricted Fund Balance - represents amounts that are constrained by external parties, constitutional provisions or enabling legislation.

Committed Fund Balance - represents amounts that can only be used for a specific purpose because of a formal action by the District's governing board. Committed amounts cannot be used for any other purpose unless the governing board removes those constraints by taking the same type of formal action. Commitments are typically done through adoption and amendment of the budget. Committed fund balance amounts differ from restricted balances in that the constraints on their use do not come from outside parties, constitutional provisions, or enabling legislation.

Assigned Fund Balance - represents amounts which the District intends to use for a specific purpose, but that do not meet the criteria to be classified as restricted or committed. Intent may be stipulated by the governing board or by an official or body to which the governing board delegates the authority. Specific amounts that are not restricted or committed in a special revenue, capital projects, debt service or permanent fund are assigned for purposes in accordance with the nature of their fund type or the fund's primary purpose. Assignments within the general fund conveys that the intended use of those amounts is for a specific purpose that is narrower than the general purposes of the District itself.

Unassigned Fund Balance - represents amounts which are unconstrained in that they may be spent for any purpose. Only the general fund reports a positive unassigned fund balance. Other governmental funds might report a negative balance in this classification because of overspending for specific purposes for which amounts had been restricted, committed or assigned.

When an expenditure is incurred for a purpose for which both restricted and unrestricted fund balance is available, the District considers restricted funds to have been spent first. When an expenditure is incurred for which committed, assigned, or unassigned fund balances are available, the District considers amounts to have been spent first out of committed funds, then assigned funds, and finally unassigned funds.

4. Changes in Accounting Policies

In March 2012, the GASB issued Statement No. 65, Items Previously Reported as Assets and Liabilities. This statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

Concepts Statement No. 4, Elements of Financial Statements, introduced and defined the elements included in financial statements, including deferred outflows of resources and deferred inflows of resources. In addition, Concepts Statement No. 4 provides that reporting a deferred outflow of resources or a deferred inflow of resources should be limited to those instances identified by the Board in authoritative pronouncements that are established after applicable due process. Prior to the issuance of this Statement, only two such pronouncements have been issued. Statement No. 53, Accounting and Financial Reporting for Derivative Instruments, requires the reporting of a deferred outflow of resources or a deferred inflow of resources for the changes in fair value of hedging derivative instruments, and Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements, requires a deferred inflow of resources to be reported by a transferor government in a qualifying service concession arrangement. This statement amends the financial statement element classification of certain items previously reported as assets and liabilities to be consistent with the definitions in Concepts Statement No. 4. This statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations. The District has implemented the provisions of this Statement for the year ended August 31, 2014.

B. Compliance and Accountability

1. Finance-Related Legal and Contractual Provisions

In accordance with GASB Statement No. 38, "Certain Financial Statement Note Disclosures," violations of finance-related legal and contractual provisions, if any, are reported below, along with actions taken to address such violations:

Violation	Action Taken
None	N/A

2. Deficit Fund Balance or Fund Net Position of Individual Funds

Following are funds having deficit fund balances or fund net position at year end, if any, along with remarks which address such deficits:

Fund Name	Deficit Amount	Remarks
None reported	Not applicable	Not applicable

C. Deposits and Investments

The District's funds are required to be deposited and invested under the terms of a depository contract. The depository bank deposits for safekeeping and trust with the District's agent bank approved pledged securities in an amount sufficient to protect District funds on a day-to-day basis during the period of the contract. The pledge of approved securities is waived only to the extent of the depository bank's dollar amount of Federal Deposit Insurance Corporation ("FDIC") insurance.

1. Cash Deposits:

At August 31, 2014, the carrying amount of the District's deposits (cash, certificates of deposit, and interest-bearing savings accounts included in temporary investments) was $2,606,357 and the bank balance was $2,726,629. At August 31, 2014, the District's deposits were entirely secured by FDIC insurance or by pledged securities held by the District's agent bank in the District's name.

In addition, the following is disclosed regarding coverage of combined balances on the date of highest deposit:

a. Depository: First Financial Bank

b. The market value of securities pledged as of the date of the highest combined balance on deposit was $3,218,204.

c. The highest combined balances of cash, savings and time deposit accounts amounted to $3,432,796 and occurred during the month of December, 2013.

d. Total amount of FDIC coverage at the time of the largest combined balance was $708,185.

2. Investments:

The District is required by Government Code Chapter 2256, The Public Funds Investment Act, to adopt, implement, and publicize an investment policy. That policy must address the following areas: (1) safety of principal and liquidity, (2) portfolio diversification, (3) allowable investments, (4) acceptable risk levels, (5) expected rates of return, (6) maximum allowable stated maturity of portfolio investments, (7) maximum average dollar-weighted maturity allowed based on the stated maturity date for the portfolio, (8) investment staff quality and capabilities, and (9) bid solicitation preferences for certificates of deposit.

The Public Funds Investment Act ("Act") requires an annual audit of investment practices. Audit procedures in this area conducted as a part of the audit of the basic financial statements disclosed that in the areas of investment practices, management reports and establishment of appropriate policies, the District adhered to the requirements of the Act. Additionally, investment practices of the District were in accordance with local policies. The Act determines the types of investments which are allowable for the District. These include, with certain restrictions, 1) obligations of the U.S. Treasury, U.S. agencies, and the State of Texas, 2) certificates of deposit, 3) certain municipal securities, 4) securities lending program, 5) repurchase agreements, 6) bankers acceptances, 7) mutual funds, 8) investment pools, 9) guaranteed investment contracts, and 10) commercial paper.

The District's investment(s) at August 31, 2014 are shown below:

Investment or Investment Type	Maturity	Fair Value
Chillicothe National Bank Certificate of Deposit	12/27/2014	187,033
Chillicothe National Bank Certificate of Deposit	1/13/2017	170,208
Chillicothe National Bank Certificate of Deposit	3/9/2015	167,801
Chillicothe National Bank Certificate of Deposit	4/9/2016	169,704
Chillicothe National Bank Certificate of Deposit	4/26/2016	307,133
Chillicothe National Bank Certificate of Deposit	10/25/2014	501,878
Chillicothe National Bank Certificate of Deposit	10/25/2014	501,878
Chillicothe National Bank Certificate of Deposit	12/12/2014	186,417
Chillicothe National Bank Certificate of Deposit	11/21/2015	151,671
Chillicothe National Bank Certificate of Deposit	12/12/2014	151,277
CDARS Certificate of Deposit	10/23/2014	206,764
Total Investments		$ 2,701,764

3. Analysis of Specific Deposit and Investment Risks

GASB Statement No. 40 requires a determination as to whether the District was exposed to the following specific investment risks at year end and, if so, the reporting of certain related disclosures:

a. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The ratings of securities by nationally recognized rating agencies are designed to give an indication of credit risk. At year end, the District was not significantly exposed to credit risk.

At August 31, 2014, the District's investments, other than those which are obligations of or guaranteed by the U.S. Government, are rated as to credit quality as follows:

Lone Star was rated AAAf

b. Custodial Credit Risk

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are uncollateralized, collateralized with securities held by the pledging financial institution, or collateralized with securities held by the pledging financial institution's trust department or agent but not in the District's name.

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government, and are held by either the counterparty or the counterparty's trust department or agent but not in the District's name.

At year end, the District was not exposed to custodial credit risk.

c. Concentration of Credit Risk

This risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. At year end, the District was not exposed to concentration of credit risk.

d. Interest Rate Risk

This is the risk that changes in interest rates will adversely affect the fair value of an investment. At year end, the District was not exposed to interest rate risk.

e. Foreign Currency Risk

This is the risk that exchange rates will adversely affect the fair value of an investment. At year end, the District was not exposed to foreign currency risk.

Investment Accounting Policy

The District's general policy is to report money market investments and short-term participating interest-earning investment contracts at amortized cost and to report nonparticipating interest-earning investment contracts using a cost-based measure. However, if the fair value of an investment is significantly affected by the impairment of the credit standing of the issuer or by other factors, it is reported at fair value. All other investments are reported at fair value unless a legal contract exists which guarantees a higher value. The term "short-term" refers to investments which have a remaining term of one year or less at time of purchase. The term "nonparticipating" means that the investment's value does not vary with market interest rate changes. Nonnegotiable certificates of deposit are examples of nonparticipating interest-earning investment contracts.

Public Funds Investment Pools

Public funds investment pools in Texas ("Pools") are established under the authority of the Interlocal Cooperation Act, Chapter 79 of the Texas Government Code, and are subject to the provisions of the Public Funds Investment Act (the "Act"), Chapter 2256 of the Texas Government Code. In addition to other provisions of the Act designed to promote liquidity and safety of principal, the Act requires Pools to: 1) have an advisory board composed of participants in the pool and other persons who do not have a business relationship with the pool and are qualified to advise the pool; 2) maintain a continuous rating of no lower than AAA or AAA-m or an equivalent rating by at least one nationally recognized rating service; and 3) maintain the market value of its underlying investment portfolio within one half of one percent of the value of its shares. The District's investments in Pools are reported at an amount determined by the fair value per share of the pool's underlying portfolio, unless the pool is 2a7-like, in which case they are reported at share value. A 2a7-like pool is one which is not registered with the Securities and Exchange Commission ("SEC") as an investment company, but nevertheless has a policy that it will, and does, operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940.

D. Capital Assets

Capital asset activity for the year ended August 31, 2014, was as follows:

	Beginning Balances	Increases	Decreases	Ending Balances
Governmental activities:				
Capital assets not being depreciated:				
Land	$ 53,122	$	$	$ 53,122
Total capital assets not being depreciated	53,122	-	-	53,122
Capital assets being depreciated:				
Buildings and improvements	3,134,107	30,779		3,164,886
Equipment	184,205	52,979		237,184
Vehicles	646,197			646,197
Total capital assets being depreciated	3,964,509	83,758	-	4,048,267
Less accumulated depreciation for:				
Buildings and improvements	(2,200,611)	(84,397)		(2,285,008)
Equipment	(126,337)	(17,668)		(144,005)
Vehicles	(517,207)	(26,399)		(543,606)
Total accumulated depreciation	(2,844,155)	(128,464)	-	(2,972,619)
Total capital assets being depreciated, net	1,120,354	(44,706)	-	1,075,648
Governmental activities capital assets, net	$ 1,173,476	$ (44,706)	$ -	$ 1,128,770

Depreciation was charged to functions as follows:

Instruction	$	52,693
Instructional Resources and Media Services		563
Curriculum and Staff Development		191
School Leadership		9,576
Guidance, Counseling, & Evaluation Services		2,356
Health Services		57
Student Transportation		26,399
Food Services		6,684
Extracurricular Activities		4,348
General Administration		13,030
Plant Maintenance and Operations		12,415
Security and Monitoring Services		115
Data Processing Services		37
	$	128,464

E. Interfund Balances and Activities

1. Due To and From Other Funds

Balances due to and due from other funds at August 31, 2014, consisted of the following:

Due To Fund	Due From Fund		Amount	Purpose
N/A	N/A		$ -	
		Total	$ -	

All amounts due are scheduled to be repaid within one year.

2. Transfers To and From Other Funds

Transfers to and from other funds at August 31, 2014, consisted of the following:

Transfers From	Transfers to		Amount	Purpose
General Fund	Other Governmental Funds		$ 16,900	Supplement other funds sources
		Total	$ 16,900	

F. Risk Management

The District is exposed to various risks of loss related to torts, theft, damage or destruction of assets, errors and omissions, injuries to employees, and natural disasters. During fiscal year 2014, the District purchased commercial insurance to cover general liabilities. There were no significant reductions in coverage in the past fiscal year and there were no settlements exceeding insurance coverage for each of the past three fiscal years.

G. Pension Plan

1. Plan Description

The District contributes to the Teacher Retirement System of Texas (TRS), a cost-sharing multiple employer defined benefit pension plan. TRS administers retirement and disability annuities, and death and survivor benefits to employees and beneficiaries of employees of the public school systems of Texas. It operates primarily under the provisions of the Texas Constitution, Article XVI, Sec. 67, and Texas Government Code, Title 8, Subtitle C. TRS also administers proportional retirement benefits and service credit transfer under Texas Government Code, Title 8, Chapters 803 and 805, respectively. The Texas state legislature has the authority to establish and amend benefit provisions of the pension plan and may, under certain circumstances, grant special authority to the TRS Board of Trustees. TRS issues a publicly available financial report that includes financial statements and required supplementary information for the defined benefit pension plan. That report may be obtained by downloading the report from the TRS internet website, www.trs.state.tx.us, under the TRS Publications heading, by calling the TRS Communications Department at 1-800-223-8778, or by writing to the TRS Communications Department, 1000 Red River Street, Austin, Texas 78701.

2. Funding Policy

Contribution requirements are not actuarially determined but are established and amended by the Texas state legislature. The state funding policy is as follows: (1) The state constitution requires the legislature to establish a member contribution rate of not less than 6.0% of the member's annual compensation and a state contribution rate of not less than 6.0% and not more than 10% of the aggregate annual compensation of all members of the system. (2) A state statute prohibits benefit improvements or contribution reductions if, as a result of a particular action, the time required to amortize TRS' unfunded actuarial liabilities would be increased to a period that exceeds 31 years, or, if the amortization period already exceeds 31 years, the period would be increased by such action. State law provides for a member contribution rate of 6.4% for fiscal years 2014, 2013 and 2012, and a state contribution rate of 6.8% for fiscal year 2014, 6.4% for fiscal year 2013 and 6.0% for fiscal year 2012. In certain instances, the reporting district is required to make all or a portion of the state's contribution. State contributions to TRS made on behalf of the District's employees for the years ending August 31, 2014, 2013 and 2012 were $78,817, $72,265 and $71,764, respectively. The District paid additional state contributions for the years ending August 31, 2014, 2013 and 2012 were $8,112, $8,988 and $7,276, respectively, on the portions of the employees' salaries that exceeded the statutory minimum.

H. Retiree Health Care Plan

1. TRS-Care

a. Plan Description

The District contributes to the Texas Public School Retired Employees Group Insurance Program (TRS-Care), a cost-sharing multiple-employer defined benefit postemployment health care plan administered by the Teacher Retirement System of Texas (TRS). TRS-Care Retired Plan provides health care coverage for certain persons (and their dependents) who retired under the Teacher Retirement System of Texas. The statutory authority for the program is Texas Insurance Code, Chapter 1575. Section 1575.052 grants the TRS Board of Trustees the authority to establish and amend basic and optional group insurance coverage for participants. The TRS issues a publicly available financial report that includes financial statements and required supplementary information for TRS-Care. That report may be obtained by visiting the TRS web site at www.trs.state.tx.us under the TRS Publications heading, by writing to the Communications Department of the Teacher Retirement System of Texas at 1000 Red River Street, Austin, Texas 78701, or by calling the TRS Communications Department at 1-800-223-8778.

b. Funding Policy

Contribution requirements are not actuarially determined but are legally established each biennium by the Texas Legislature. Texas Insurance Code, Sections 1575.202, 203, and 204 establish state, active employee, and public

school contributions, respectively. Funding for free basic coverage is provided by the program based upon public school district payroll. Per Texas Insurance Code, Chapter 1575, the public school contribution may not be less than 0.25% or greater than 0.75% of the salary of each active employee of the public school. Funding for optional coverage is provided by those participants selecting the optional coverage. The State of Texas contribution rate was 1.0% for the fiscal year 2014, 0.5% for the fiscal year 2013 and 1.0% for the fiscal year 2012 and the active public school employee contribution rates were 0.65% of public school payroll, respectively, with school districts contributing a percentage of payroll set at 0.55% for fiscal years 2014, 2013 and 2012.

For the years ended August 31, 2014, 2013, and 2012, the State's contributions to TRS-Care were $13,712, $6,793, and $14,082, respectively, the active member contributions were $8,913, $8,831, and $9,153, respectively, and the District's contributions were $7,542, $7,472, and $7,745, respectively, which equaled the required contributions each year.

2. Medicare Part D Subsidies

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003, which was effective January 1, 2006, established prescription drug coverage for Medicare beneficiaries known as Medicare Part D. One of the provisions of Medicare Part D allows for the Texas Public School Retired Employee Group Insurance Program (TRS-Care) to receive retiree drug subsidy payments from the federal government to offset certain prescription drug expenditures for eligible TRS-Care participants. For the fiscal years ended August 31, 2014, 2013, and 2012, the subsidy payments received by TRS-Care on behalf of the District were $3,591, $3,794, and $3,109, respectively.

I. Commitments and Contingencies

1. Contingencies

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

2. Litigation

No reportable litigation was pending against the District at August 31, 2014.

J. Shared Services Arrangements

Shared Services Arrangement - Membership
The District participates in a shared service arrangement ("SSA") for a special education program with the following school districts:

Member Districts
Childress ISD
Crowell ISD
Memphis ISD
Quanah ISD

The District does not account for revenues or expenditures in the program and does not disclose them in these financial statements. The District neither has a joint ownership interest in capital assets purchased by the fiscal agent, nor does the

District have a net equity interest in the fiscal agent. The fiscal agent is neither accumulating significant financial resources nor fiscal exigencies that would give rise to a future additional benefit to the District. The fiscal agent manager is responsible for all financial activities of the SSA.

K. Committed and Assigned Fund Balance

The Board of Trustees has committed a total of $1,405,000 of general fund balance for the following purpose:

Facilities Repairs and Improvements	$	646,700
Transportation Purchases		182,300
Cash Reserves for Operating Expenses and Delayed Payments		509,793
Electronics and Technology Updates and Replacements		66,207
Total Commited General Fund Balance	$	1,405,000

L. Self-insured Worker's Compensation Plan

The District maintains a self-insured worker's compensation plan. The District has third party insurance coverage for aggregate claims in excess of $5 million and for specific occurrences exceeding $500,000. Pool participants are responsible for amounts up to this single limit; however, the District loss fund maximum was $14,513 for the plan year ended August 31, 2014.

The estimated claims benefit obligation for the self-insured worker's compensation plan of $37,783 at August 31, 2014 includes requirements of GASB Statement No. 10, which requires that a liability for claims be reported if information prior to the issuance of the financial statements indicated that it is probable that a liability has been incurred as of the date of the financial statements, and the amount of the loss can be reasonably estimated. Because actual claim liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing the liability does not result necessarily in an exact amount. The liability recorded was the undiscounted estimate of the third party administrator at August 31, 2014. The District's ultimate liability is the sum of the District's loss fund as determined by the third party administrator.

The District is not responsible for claims and claims allocation expense beyond its stop loss insurance coverage noted above.

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Required Supplementary Information

Required supplementary information includes financial information and disclosures required by the Governmental Accounting Standards Board but not considered a part of the basic financial statements.

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CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

GENERAL FUND
BUDGETARY COMPARISON SCHEDULE
FOR THE YEAR ENDED AUGUST 31, 2014

EXHIBIT G-1

Data Control Codes		1 Budgeted Amounts Original	2 Budgeted Amounts Final	3 Actual	Variance with Final Budget Positive (Negative)
	REVENUES:				
5700	Local and Intermediate Sources	$ 2,618,518	$ 2,618,518	$ 2,681,028	$ 62,510
5800	State Program Revenues	670,355	670,355	669,992	(363)
5020	Total Revenues	3,288,873	3,288,873	3,351,020	62,147
	EXPENDITURES:				
	Current:				
	Instruction & Instructional Related Services:				
0011	Instruction	1,129,622	1,287,797	1,265,536	22,261
0012	Instructional Resources and Media Services	6,334	6,334	5,294	1,040
0013	Curriculum and Staff Development	5,286	5,286	4,825	461
	Total Instruction & Instr. Related Services	1,141,242	1,299,417	1,275,655	23,762
	Instructional and School Leadership:				
0023	School Leadership	247,514	247,514	241,931	5,583
	Total Instructional & School Leadership	247,514	247,514	241,931	5,583
	Support Services - Student (Pupil):				
0031	Guidance, Counseling and Evaluation Services	59,642	59,842	59,603	239
0033	Health Services	7,210	7,210	1,438	5,772
0034	Student (Pupil) Transportation	83,724	88,724	58,668	30,056
0035	Food Services	2,787	2,787	2,787	--
0036	Cocurricular/Extracurricular Activities	102,835	133,198	132,853	345
	Total Support Services - Student (Pupil)	256,198	291,761	255,349	36,412
	Administrative Support Services:				
0041	General Administration	283,044	356,892	329,589	27,303
	Total Administrative Support Services	283,044	356,892	329,589	27,303
	Support Services - Nonstudent Based:				
0051	Plant Maintenance and Operations	332,633	357,633	341,272	16,361
0052	Security and Monitoring Services	9,250	9,250	2,314	6,936
0053	Data Processing Services	2,465	2,465	942	1,523
	Total Support Services - Nonstudent Based	344,348	369,348	344,528	24,820
	Intergovernmental Charges:				
0092	Increment Costs Associated Chapter 41 (WADA)	5,700	5,700	--	5,700
0093	Payments to Fiscal Agent/Member Dist.-SSA	23,004	23,004	23,004	--
0099	Other Intergovernmental Charges	45,230	45,230	40,123	5,107
	Total Intergovernmental Charges	73,934	73,934	63,127	10,807
6030	Total Expenditures	2,346,280	2,638,866	2,510,179	128,687
1100	Excess (Deficiency) of Revenues Over (Under)				
1100	Expenditures	942,593	650,007	840,841	190,834
	Other Financing Sources (Uses):				
8911	Transfers Out	(6,500)	(16,900)	(16,900)	--
7080	Total Other Financing Sources and (Uses)	(6,500)	(16,900)	(16,900)	--
1200	Net Change in Fund Balance	936,093	633,107	823,941	190,834
0100	Fund Balance - Beginning	1,966,310	1,966,310	1,966,310	--
3000	Fund Balance - Ending	$ 2,902,403	$ 2,599,417	$ 2,790,251	$ 190,834

Budget

The official budget was prepared for adoption for all Governmental Fund Types. The budget was prepared in accordance with accounting practices generally accepted in the United States of America. The following procedures are followed in establishihng the budgetary data reflected in the basic financial statements:

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

b. A meeting of the Board is then called for the purpose of adopting the proposed budget after ten days' public notice of the meeting has been given.

c. Prior to September 1, the budget is legally enacted through passage of a resolution by the Board.

Once a budget is approved, it can be amended at function and fund level only by approval of a majority of the members of the Board. Amendments are presented to the Board at its regular meetings.

Each amendment must have Board approval. Such amendments are made before the fact, are reflected in the official minutes of the Board and are not made after fiscal year end as required by law.

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

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

Other Supplementary Information

This section includes financial information and disclosures not required by the Governmental Accounting Standards Board and not considered a part of the basic financial statements. It may, however, include information which is required by other entities.

CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

SCHEDULE OF DELINQUENT TAXES RECEIVABLE
FOR THE YEAR ENDED AUGUST 31, 2014

Year Ended August 31	1 Tax Rates Maintenance	2 Tax Rates Debt Service	3 Assessed/Appraised Value For School Tax Purposes
2005 and Prior Years	$ Various	$ Various	$ Various
2006	1.45	--	87,339,450
2007	1.33	--	102,810,490
2008	1.04	--	105,590,300
2009	1.04	--	124,475,269
2010	1.04	--	113,130,193
2011	1.04	--	118,204,370
2012	1.04	--	113,938,950
2013	1.04	--	124,969,630
2014 (School Year Under Audit)	1.04	--	241,245,240
1000 Totals			
9000 - Portion of Row 1000 for Taxes Paid into Tax Increment Zone Under Chapter 311, Tax Code			

10 Beginning Balance 9/1/13	20 Current Year's Total Levy	31 Maintenance Collections	32 Debt Service Collections	40 Entire Year's Adjustments	50 Ending Balance 8/31/14
$ 64,219	$ --	$ 5,973	$ --	$ (10,440)	$ 47,806
4,890	--	539	--	(403)	3,948
4,591	--	621	--	(362)	3,608
4,315	--	1,164	--	(229)	2,922
10,857	--	1,128	--	(445)	9,284
5,392	--	1,249	--	(454)	3,689
7,595	--	1,946	--	(169)	5,480
8,544	--	3,509	--	(84)	4,951
21,196	--	13,565	--	(20)	7,611
--	2,500,571	2,468,992	--	(456)	31,123
$ 131,599	$ 2,500,571	$ 2,498,686	$ --	$ (13,062)	$ 120,422
$ --	$ --	$ --	$ --	$ --	$ --

CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

NATIONAL SCHOOL BREAKFAST AND LUNCH PROGRAM
BUDGETARY COMPARISON SCHEDULE
FOR THE YEAR ENDED AUGUST 31, 2014

EXHIBIT J-2

Data Control Codes		1 Budget	2 Actual	3 Variance Positive (Negative)
	REVENUES:			
5700	Local and Intermediate Sources	$ 27,972	$ 22,057	$ (5,915)
5800	State Program Revenues	725	716	(9)
5900	Federal Program Revenues	128,936	134,936	6,000
5020	Total Revenues	157,633	157,709	76
	EXPENDITURES:			
	Current:			
	Support Services - Student (Pupil):			
0035	Food Services	170,733	166,286	4,447
	Total Support Services - Student (Pupil)	170,733	166,286	4,447
	Support Services - Nonstudent Based:			
0051	Plant Maintenance and Operations	3,800	3,557	243
	Total Support Services - Nonstudent Based	3,800	3,557	243
6030	Total Expenditures	174,533	169,843	4,690
1100	Excess (Deficiency) of Revenues Over (Under)			
1100	Expenditures	(16,900)	(12,134)	4,766
	Other Financing Sources (Uses):			
7915	Transfers In	16,900	16,900	--
7080	Total Other Financing Sources and (Uses)	16,900	16,900	--
1200	Net Change in Fund Balance	--	4,766	4,766
0100	Fund Balance - Beginning	9,819	9,819	--
3000	Fund Balance - Ending	$ 9,819	$ 14,585	$ 4,766

KING, MOORE, TRUELOVE & PHARIS

Certified Public Accountants
Michael C. Moore, *CPA*
John T. Truelove, *CPA*
Douglas A. Pharis, *CPA*

Independent Auditor's Report on Internal Control over Financial Reporting and On Compliance and Other Matters Based on an Audit of Financial Statements Performed In Accordance With *Government Auditing Standards*

To the Board of Trustees
Chillicothe Independent School District
Chillicothe, Texas

Members of the Board of Trustees:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Chillicothe Independent School District, as of and for the year ended August 31, 2014, and the related notes to the financial statements, which collectively comprise Chillicothe Independent School District's basic financial statements, and have issued our report thereon dated November 18, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Chillicothe Independent School District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Chillicothe Independent School District's internal control. Accordingly, we do not express an opinion on the effectiveness of Chillicothe Independent School District's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Chillicothe Independent School District's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on

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compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

King, Moore, Truelove & Pharis

Vernon, TX
November 18, 2014

CHILLICOTHE INDEPENDENT SCHOOL DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED AUGUST 31, 2014

A. Summary of Auditor's Results

1. Financial Statements

Type of auditor's report issued:	Unmodified		
Internal control over financial reporting:			
One or more material weaknesses identified?	____ Yes	__X__ No	
One or more significant deficiencies identified that are not considered to be material weaknesses?	____ Yes	__X__ None Reported	
Noncompliance material to financial statements noted?	____ Yes	__X__ No	

B. Financial Statement Findings

NONE

C. Federal Award Findings and Questioned Costs

NONE

CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED AUGUST 31, 2014

Finding/Recommendation	Current Status	Management's Explanation If Not Implemented
Finding 2013-1 - Material Weakness in Financial Reporting		
During the prior year audit, the District was undersecured by the depository financial institution at times during the fiscal year by amounts that were material to the financial statements. Relative to the 2013-2014 audit, no such conditions were noted.	Implemented	

CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

CORRECTIVE ACTION PLAN
FOR THE YEAR ENDED AUGUST 31, 2014

None

CHILLICOTHE INDEPENDENT SCHOOL DISTRICT

SCHEDULE OF REQUIRED RESPONSES TO SELECTED SCHOOL FIRST INDICATORS
AS OF AUGUST 31, 2014

Data Control Codes		Responses
SF2	Were there any disclosures in the Annual Financial Report and/or other sources of information concerning default on bonded indebtedness obligations?	No
SF4	Did the District receive a clean audit? - Was there an unmodified opinion in the Annual Financial Report?	Yes
SF5	Did the Annual Financial Report disclose any instances of material weaknesses in internal controls?	No
SF9	Was there any disclosure in the Annual Financial Report of material noncompliance?	No
SF10	What was the total accumulated accretion on capital appreciation bonds included in the government-wide financial statements at fiscal year-end?	$ --

APPENDIX C

FORM OF CO-BOND COUNSEL OPINION

POWELL & LEON, L.L.P.
115 Wild Basin Rd, Ste 106
Austin, Texas 78746

MCGUIREWOODS LLP
600 Travis, Suite 7500
Houston, Texas 77002

July 30, 2015

We have acted as Co-Bond Counsel in connection with the issuance by the Chillicothe Independent School District (the "District") of its Unlimited Tax School Building Bonds, Series 2015 (the "Bonds"), dated July 1, 2015, in the aggregate principal amount of $3,740,000. The Bonds are issuable in fully registered form only, in denominations of $5,000 or integral multiples thereof, bear interest, are subject to redemption prior to maturity and may be transferred and exchanged as set out in the Bonds and in the order (the "Order") adopted by the Board of Trustees of the District authorizing their issuance.

We have acted as Co-Bond Counsel for the sole purpose of rendering an opinion with respect to the legality and validity of the Bonds under the Constitution and laws of the State of Texas and with respect to the exclusion of interest on the Bonds from gross income under federal income tax law. In such capacity, we have examined the Constitution and laws of the State of Texas; federal income tax law; and a transcript of certain certified proceedings pertaining to the issuance of the Bonds. The transcript contains certified copies of certain proceedings of the District; certain certifications and representations and other material facts within the knowledge and control of the District, upon which we rely; and certain other customary documents and instruments authorizing and relating to the issuance of the Bonds. We have also examined executed Bond No. R-1 of this issue.

We have not been requested to examine, and have not investigated or verified, any original proceedings, records, data or other material, but have relied upon the transcript of certified proceedings. We have not assumed any responsibility with respect to the financial condition or capabilities of the District or the disclosure thereof in connection with the sale of the Bonds. Our role in connection with the District's Official Statement prepared for use in connection with the sale of the Bonds has been limited as described therein.

Based on such examination, it is our opinion as follows:

1) The transcript of certified proceedings evidences complete legal authority for the issuance of the Bonds in full compliance with the Constitution and laws of the State of Texas presently in effect; the Bonds constitute valid and legally binding obligations of the District enforceable in accordance with the terms and conditions thereof, except to the extent that the rights and remedies of the owners of the Bonds may be limited by laws heretofore or hereafter enacted relating to

bankruptcy, insolvency, reorganization, moratorium or other similar laws affecting the rights of creditors of political subdivisions and the exercise of judicial discretion in appropriate cases; and the Bonds have been authorized and delivered in accordance with law; and

2) The Bonds are payable, both as to principal and interest, from the receipts of all annual ad valorem tax levied, without legal limit as to rate or amount, upon taxable property located within the District, which taxes have been pledged irrevocably to pay the principal of and interest on the Bonds; and

Also based on our examination as described above, it is our further opinion that, subject to the restrictions hereinafter described, interest on the Bonds, including any accrued "original issue discount" properly allocable to the holders of the Bonds, is excludable from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended ("Code"), and is not a specific item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. For purposes of the alternative minimum tax imposed on corporations under Section 56 of the Code, interest on the Bonds is included in computing adjusted current earnings. The "original issue discount" on any Bond is the excess of its stated redemption price at maturity over the initial offering price to the public at which price a substantial amount of the Bonds of the same maturity was sold. The "public" does not include bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers. We express no opinion regarding other federal tax consequences arising with respect to the Bonds.

In providing the opinion set forth in the foregoing paragraph, we are assuming continuing compliance with the Covenants (as hereinafter defined) by the District. The Code and the regulations promulgated thereunder contain a number of requirements that must be satisfied after the issuance of the Bonds in order for interest on the Bonds to be and remain excludable from gross income for purposes of federal income taxation. These requirements include, by way of example and not limitation, restrictions on the use, expenditure and investment of the proceeds of the Bonds and the use of the property financed by the Bonds, limitations on the source of the payment of and the security for the Bonds, and the obligation to rebate certain excess earnings on the gross proceeds of the Bonds to the United States Treasury. The Order and the District's tax certificate for the Bonds (the "Tax Certificate") contain covenants (the "Covenants") under which the District has agreed to comply with such requirements. Failure by the District to comply with the Covenants could cause interest on the Bonds to become includable in gross income for federal income tax purposes retroactively to their date of issue. In the event of noncompliance with the Covenants, the available enforcement remedies may be limited by applicable provisions of law and, therefore, may not be adequate to prevent interest on the Bonds from becoming includable in gross income for federal income tax purposes. We have no responsibility to monitor compliance with the Covenants after the date of issue of the Bonds.

Certain requirements and procedures contained, incorporated or referred to in the Order and Tax Certificate, including the Covenants, may be changed and certain actions may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents.

Our opinions are based on existing law, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty to update or supplement our opinions to reflect any facts or circumstances that may thereafter come to our attention or to reflect any changes in any law that may thereafter occur or become effective. Moreover, our opinions are not a guarantee of result and are not binding on the Internal Revenue Service; rather, such opinions represent our legal judgment based upon our review of existing law that we deem relevant to such opinions and in reliance upon the representations and covenants referenced above.