

NOVEMBER 2015

ALSO INSIDE THIS ISSUE:

“SETTING ASIDE” MONEY FOR COLLEGE 8

MICROFINANCE MAKES BIG IMPACT 11

STATE REVENUE WATCH 15



FISCAL NOTES

How Texas Taxes “Sin”

by Lisa Minton

LEVIES PLAY DUAL ROLE

Texas collects most of its tax revenue on retail sales and various forms of business activity. Some taxes, however, commonly called “sin taxes,” are levied on the sale of alcohol and tobacco products as well as activities related to gambling. While these taxes, like all state levies collected in Texas, help fund state programs, they’re *also* intended to deter people from activities considered detrimental to their health or to society.

Texas’ sin tax collections reached \$3.8 billion in 2015, accounting for 7.3 percent of all tax collections and 3.5 percent of total state revenue (**Exhibit 1**). (This analysis includes lottery revenue as a tax.)

Of the sin taxes, those on cigarettes and other tobacco products brought in the most revenue, at \$1.5 billion. State revenue from gambling activities, which in Texas include the state lottery and pari-mutuel horse and dog racing, brought in \$1.2 billion in 2015, although 99.7 percent of that total came from the state’s share of lottery proceeds alone. Alcoholic beverages contributed another \$1.1 billion in taxes, about 30 percent of all sin tax collections.

A LONG, SINFUL HISTORY

In the U.S., sin taxes can be traced back to the late 18th century, when the new nation assumed the debts incurred by the colonies during the Revolutionary War. To fund the debt, President George Washington’s Secretary of the Treasury, Alexander Hamilton, proposed a 7-cent-per-gallon tax on domestically produced



EXHIBIT 1

TEXAS SIN TAX COLLECTIONS, 2015

SOURCES	2015 COLLECTIONS	SHARE OF TOTAL TEXAS TAX REVENUE
ALCOHOLIC BEVERAGE TAXES	\$1,138,775,576	2.16%
CIGARETTE AND TOBACCO TAXES	\$1,532,414,267	2.90%
GAMBLING*	\$1,155,810,492	2.19%
TOTAL SIN TAXES	\$3,829,656,214	7.25%
ALL TEXAS TAX COLLECTIONS*	\$52,838,870,492	100.00%

* Includes state share of lottery proceeds.
Source: Texas Comptroller of Public Accounts

distilled spirits. Approved by Congress as part of the Revenue Act of 1791, this “whiskey tax” was the first excise tax levied on a domestic product in the nation’s history. (An excise tax is a per-unit tax levied on a product.)

Tobacco taxes followed soon after, but were quickly repealed and did not surface again until the Civil War.

Farmers strongly resisted the whiskey tax, as many were using part of their harvests to produce distilled spirits for sale. Their refusal to pay the tax led to violence against its collectors during the infamous Whiskey Rebellion, which ended in 1794 when President Washington himself led 13,000 troops into western Pennsylvania to suppress the insurrection and confirm the supremacy of federal laws within the states.

The whiskey tax was repealed during Thomas Jefferson’s presidency, and distilled spirits remained untaxed until the 1860s, when the cost of the Civil War forced Congress to resume taxing alcohol — and

CONTINUED ON PAGE 3

A Message from the Comptroller

The Supreme Court Justice Oliver Wendell Holmes Jr. once said “Taxes are what we pay for civilized society.” And we taxpayers know we’ve been asked to pay that price on a dizzying variety of goods and activities — even the ones that aren’t good for us.



In this issue of *Fiscal Notes*, we continue our examination of the taxes that support Texas’ state and local governments. This time, we look at the curious category often called sin taxes.

Sin taxes traditionally include those levied on tobacco and alcohol. The revenues raised by state-sanctioned gambling, such as pari-mutuel racing and state lotteries, are often counted as well. They’re a small but important part of Texas’ tax structure and may (or may not) spur us to cut back on bad habits, too.

We also examine “set-asides,” the portion reserved from tuition at public universities to support financial aid for those who lack the funds for college. Set-asides have become ever more important as the cost of college continues to soar, but some question whether they should be replaced by direct state funding for student aid.

Finally, we take a look at “microlending,” small loans made by nonprofits to support beginning businesses and encourage the growth of local economies. In South Texas in particular, microloans have helped thousands of people who couldn’t obtain traditional loans start businesses, creating jobs for their neighbors and strengthening their communities as well.

As always, I hope you enjoy this issue!

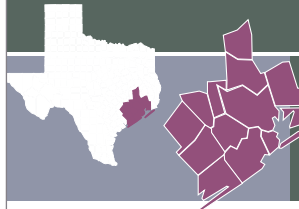
REGIONAL SNAPSHOT: GULF COAST REGION

As the state’s chief financial officer, I’m charged with monitoring the state’s economic health. Therefore, it’s vitally important that my office studies factors related to our regional economies.

The 13 counties comprising the Gulf Coast Region have helped boost Texas’ remarkable growth and resiliency over the past 10 years.

-GLENN HEGAR

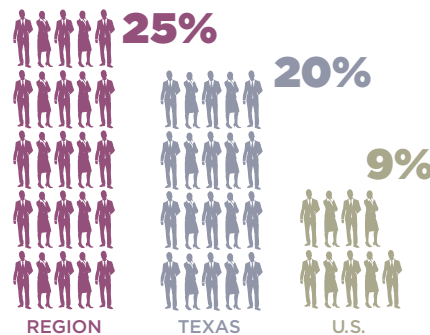
Texas Comptroller of Public Accounts



GULF COAST REGION COUNTIES:

AUSTIN	GALVESTON	WALKER
BRAZORIA	HARRIS	WALLER
CHAMBERS	LIBERTY	WHARTON
COLORADO	MATAGORDA	
FORT BEND	MONTGOMERY	

POPULATION GROWTH GULF COAST REGION VS. TEXAS AND U.S. / 2003-2013



Source: U.S. Bureau of Economic Analysis

THE GULF COAST REGION ACCOUNTED FOR

45%

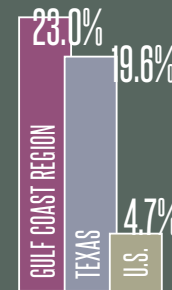
OF ALL NET MIGRATION TO TEXAS IN 2013.

Source: U.S. Census Bureau

JOBS & WAGES

The Gulf Coast Region added nearly 540,000 jobs from 2003 to 2013 — nearly 30 percent of all Texas job growth — and had the state’s highest average wages (\$60,534) in 2013.

JOB GROWTH 2003-2013



Source: Economic Modeling Specialists Intl.

WITH 532 PEOPLE PER SQUARE MILE, THE GULF COAST REGION IS TEXAS’ MOST DENSELY POPULATED.

Source: U.S. Bureau of Economic Analysis

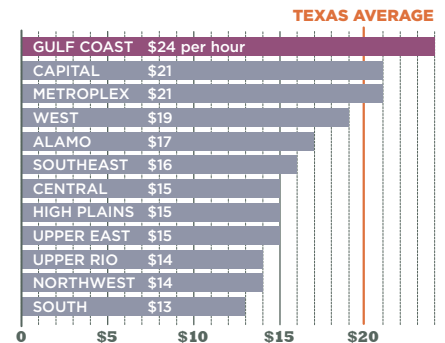
PER CAPITA PERSONAL INCOME GROWTH 2003-2013



Source: U.S. Bureau of Economic Analysis and Texas Comptroller of Public Accounts

INCOME INEQUALITY WAGE GAP BETWEEN EARNERS AT THE TOP AND BOTTOM 10 PERCENT

The Gulf Coast Region has the state’s widest margin between high- and low-income earners. Education is a factor in the disparity; the region has a relatively high share of science, technology, engineering and mathematics jobs (22 percent).



Sources: Economic Modeling Specialists Intl. and Texas Comptroller of Public Accounts

FOR A COMPLETE LIST OF REGIONAL SNAPSHOTS, VISIT: TEXASAHEAD.ORG/REGIONALRPTS

additional goods, including cigars and other tobacco products — as part of the Revenue Act of 1862. In fact, between the Civil War and the creation of the federal income tax in 1913, most of the nation’s non-tariff revenue derived from excise taxes such as those on liquor and tobacco.

Most states began levying their own excise taxes on alcohol and tobacco products in the 1930s, when the Great Depression dented their other revenues. Lawmakers sought new revenue sources that would not overly burden the already struggling population.

AN “EASY” TAX?

Today, all 50 states and the federal government impose some sort of tax on cigarettes and alcoholic beverages. State lawmakers often see sin tax increases as easier, politically, than raising state income, property or sales taxes, and in recent years have relied on them extensively to patch budgets. Since 2000, states collectively enacted 125 cigarette tax increases and another 31 on alcohol. The same period saw only 21 increases to state sales taxes, for instance.

One reason sin taxes may be more palatable than other taxes is because they fall only on those who use the product or partake in the activity — and many disapprove of the items and activities in question anyway. Also, sin taxes generally are built into the retail price of the product or activities and consumers are not always aware they’re paying them.

Generally, these taxes don’t produce a significant share of state revenue, although some states rely on them much more than others. *Governing* magazine recently listed Rhode Island as the state most dependent on sin taxes, which contribute 15.9 percent of that state’s total tax revenue (**Exhibit 2**). Texas’ share was 4.6 percent, slightly above the national average of 3.8 percent in 2014. (Note that these percentages do not include lottery proceeds.)

IN TEXAS

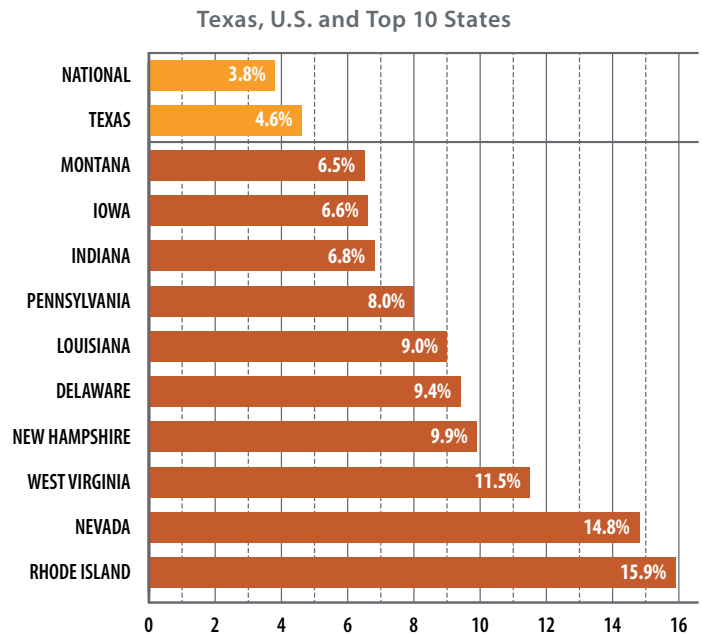
Generally, the state turns to sin taxes during times of budget crisis; the Legislature also may impose sin taxes for specific funding purposes.

Texas has taxed liquor and cigarettes since the Great Depression. Pari-mutuel betting in Texas has come and gone over the years; it was legal from 1905 to 1909, again from 1933 to 1937 and finally from 1987 to the present. The Texas Lottery sold its first tickets in 1992 (**Exhibit 3**).

Texas levies two types of tobacco taxes — one on cigarettes and another on cigars and other tobacco products (e.g., chewing tobacco, pipe tobacco and snuff). The 1931 Texas Legislature created the first Texas tobacco tax, enacting a 3-cent levy on each pack of

EXHIBIT 2

SIN TAXES AS A PERCENTAGE OF TOTAL STATE TAX REVENUE, 2014



Note: Lottery proceeds **not** included in this calculation.
Source: *Governing*, August 2015

20 cigarettes. Between 1950 and 1990, this rate increased nine times, reaching 41 cents per pack, where it remained until 2006. In that year, a special session of the 2005 Legislature voted to raise the cigarette tax rate to \$1.41 — an increase of \$1 per pack of 20 — effective January 1, 2007.

Originally, cigars and some other tobacco products were taxed under the cigarette tax law. In 1959, the Legislature created a separate tax for cigars and other tobacco products, taxing cigars by volume and other tobacco products by factory price. Snuff was added to the tax in 1984. In 2009, further legislation changed the basis of the tax on other tobacco products to weight.

Texas began taxing alcoholic beverages in 1935, and currently has six separate alcohol taxes. Four are excise taxes on liquor, beer, wine and malt liquor (**Exhibit 4**). These taxes are remitted at the wholesale level by distributors.

Two other taxes, on mixed beverage gross receipts and mixed beverage sales, are imposed on all alcoholic beverages sold to consumers by restaurants and bars permitted to serve liquor. The mixed beverage gross receipts tax was levied at a rate of 14 percent before 2013, when the mixed beverage sales tax was introduced. In fiscal 2014, the gross receipts tax was

CONTINUED ON PAGE 4

reduced to 6.7 percent. (Incidentally, the alcoholic beverage taxes as a group were the only type of Texas tax that weathered the Great Recession without declining.)

The 2015 Legislature repealed another alcohol tax, levied on alcoholic beverages sold to train and airline passengers, as of Sept. 1, 2015.

GAMBLING ON REVENUE

In 1987, Texas voters approved a statewide referendum allowing pari-mutuel wagering on horse and greyhound races. At present, the state has four active horse racing tracks and three greyhound tracks that are inactive but offering betting on races simulcast from other states (**Exhibit 5**). In 2015, these tracks brought in about \$3 million in state general revenue. The popularity of pari-mutuel racing has declined considerably in recent years, however, and the 2015 total represents less than a third of what the state realized in 1993.

The Texas Racing Commission (TRC) has proposed expanding gambling at horse and dog tracks by allowing “historical racing” — a game played on a device resembling a video slot machine that allows gamblers to bet on replays of old races — and promulgated rules for the activity. Racing industry

proponents claim this feature could generate hundreds of millions in additional revenue for the state. Some members of the Legislature oppose TRC’s proposal, however, and a district court has struck down the rules. At this writing, historical racing is not yet offered at Texas tracks.



EXHIBIT 4

MAJOR TEXAS AND FEDERAL ALCOHOLIC BEVERAGE EXCISE TAX RATES, 2015

	BEER*	LIQUOR	MALT LIQUOR (ALE)*	TABLE WINE**
STATE	\$6/Barrel (19.4¢/Gallon)	\$2.40/Gallon	19.8¢/Gallon	20.4¢/Gallon
FEDERAL	\$18/Barrel (58.1¢/Gallon)	\$13.50/Gallon	\$18/Barrel (58.1¢/Gallon)	\$1.07/Gallon

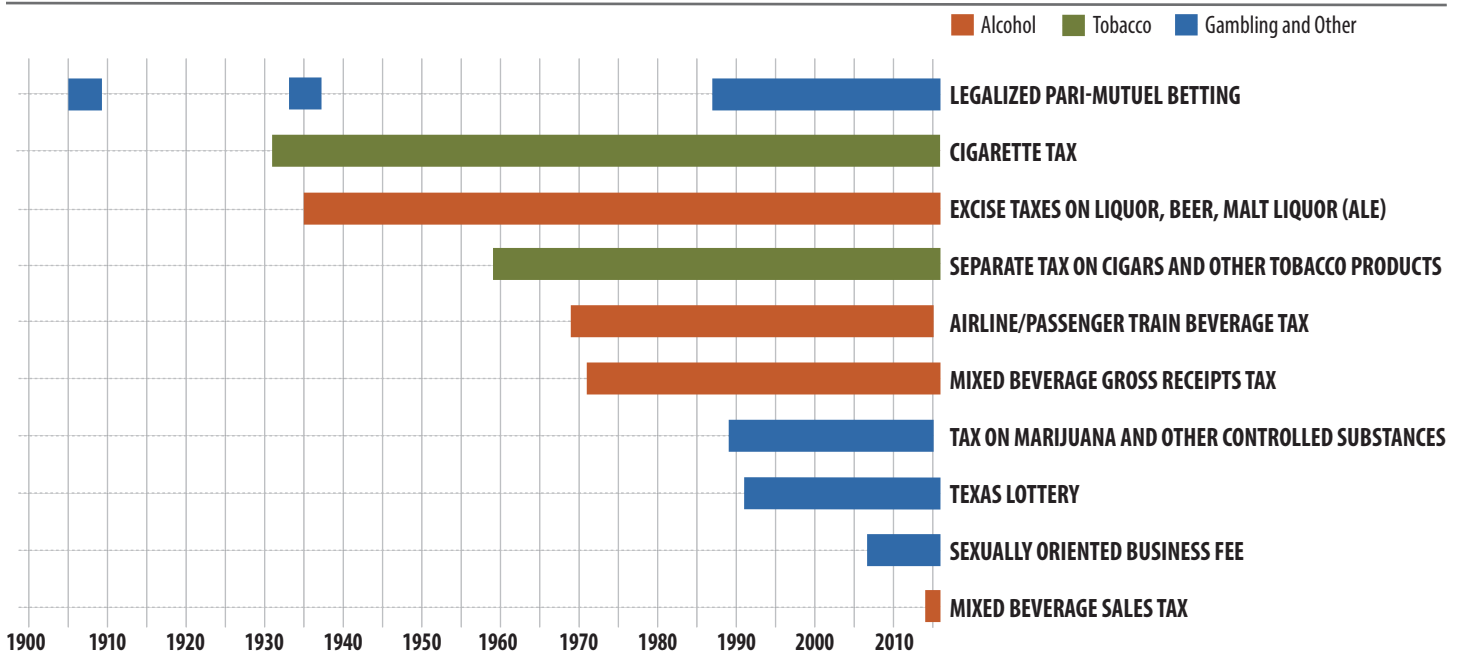
* Barrels are industry-standard 31-gallon containers.

** For wines with an alcohol volume of 14 percent or less.

Sources: Texas Comptroller of Public Accounts and U.S. Alcohol and Tobacco Tax and Trade Bureau

EXHIBIT 3

ADOPTION OF TEXAS SIN TAXES



Sources: Texas Comptroller of Public Accounts and U.S. Alcohol and Tobacco Tax and Trade Bureau

In 1991, state voters approved a constitutional amendment authorizing the Texas Lottery. The question of whether a state's share of lottery proceeds constitutes a "sin tax" is debatable, but the Tax Foundation, a national tax policy research organization, maintains that if a state's intent in offering a lottery is to raise revenues for the state — as in Texas, where net lottery proceeds support public education — the payment is a tax.

OTHER TEXAS SIN TAXES

Despite the fact that marijuana is still illegal in most U.S. jurisdictions, many states — including Texas, until recently — impose taxes on the sale of marijuana as well as other controlled substances. Texas imposed such a tax on the dealer (defined by law as one who imports, manufactures, produces, acquires or possesses a controlled substance) at a rate of \$3.50 per gram for marijuana and \$200 per gram for other controlled substances.

The Legislature repealed Texas' controlled substances tax effective Sept. 1, 2015, but not at any great cost to the state. While the Comptroller did collect a little revenue from the tax each year (less than \$7,400 in fiscal 2015), the number of stamps issued was minimal and most likely were purchased by collectors.

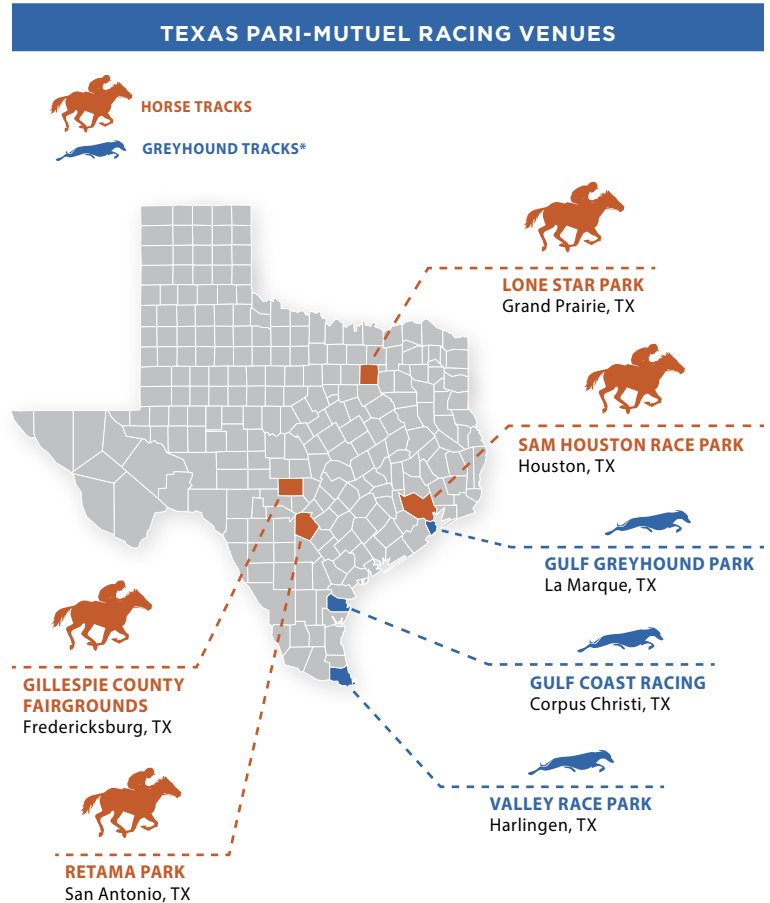
In states where marijuana is legal, however, tax revenues can be significant. In September, for instance, Colorado's Department of Revenue reported that the state's taxes on the drug, which is legal there for recreational use, totaled nearly \$70 million in fiscal 2015, while alcohol taxes raised just \$42 million.

Another Texas levy, imposed in 2007, is collected at establishments that host live nude shows and also allow alcohol consumption on their premises. This \$5-per-patron fee, officially named the sexually oriented business fee (and nicknamed the "pole tax" since strip clubs are subject to it), is used to support sexual assault victims' assistance programs and provide health insurance for the poor.

Texas' Third Court of Appeals upheld this tax in 2014, following a number of challenges by the adult entertainment industry. It generated \$8.9 million in fiscal 2015.

The court's opinion stated that "the tax's primary purpose is to discourage this type of business activity altogether while also generating revenue to ameliorate the type of social ills that are associated with this type of business."

EXHIBIT 5



*Tracks do not currently offer live racing, but allow betting on simulcast races from other states.
Source: Texas Racing Commission

A DETERRENT EFFECT?

As the court indicated, sin taxes not only raise revenue for government, but also can be intended as a deterrent to behaviors considered harmful. The belief is that the higher the taxes, the more people will be discouraged from engaging in these behaviors.

For example, many people believe that cigarette taxes reduce smoking and thus improve public health. While studies vary widely on this issue, many indicate that the cigarette tax does indeed serve as a deterrent — but more so for younger people than for older, long-term smokers.

In Texas, per-capita taxed cigarette sales peaked in 1982 at 131.2 packs a year, but by 2014 had declined to 33.7 packs per year, a 74.3 percent decrease (**Exhibit 6**). During those 32 years, the combined Texas and federal cigarette tax rates increased by 812 percent, from 26.5 cents a pack to \$2.42. While these numbers may suggest a correlation between rising cigarette prices and decreased sales, many other

CONTINUED ON PAGE 6



factors may be involved, such as growing public awareness of smoking risks, public smoking bans and prevention efforts aimed at children and teens.

Sin taxes are “flat” taxes, applying the same tax rate to every taxpayer regardless of income and without deductions or exemptions. For this reason, many consider them unfair because the tax costs the poor a larger share of their income than the higher-income population. But this phenomenon, called “regressivity” in tax lingo, applies to excise taxes in general, because everyone pays the same amount per product or service, regardless of income. (Income taxes, by contrast, are “progressive,” since rates rise as income increases.)

THE FUTURE OF SIN

While alcohol and tobacco have been the historic focus of sin taxes, today a growing number of other consumer products are being singled out. Some states,



for example, now tax certain foods and beverages that are high in sugar, trans fats and other ingredients considered unhealthy, and associated with the rising incidence of obesity and Type 2 diabetes.

In the event of a future budget crisis, it’s possible that Texas lawmakers will consider raising rates on current sin taxes or even creating new ones. Soda and candy taxation proposals have come up for legislative debate in the past, as has the expansion of gambling.

Gambling proponents suggest the state could raise substantial amounts by legalizing and taxing casino gambling, although estimates of potential revenue range widely and would depend on the number of casinos, the types of games authorized and the portion of gaming revenue going to the state.

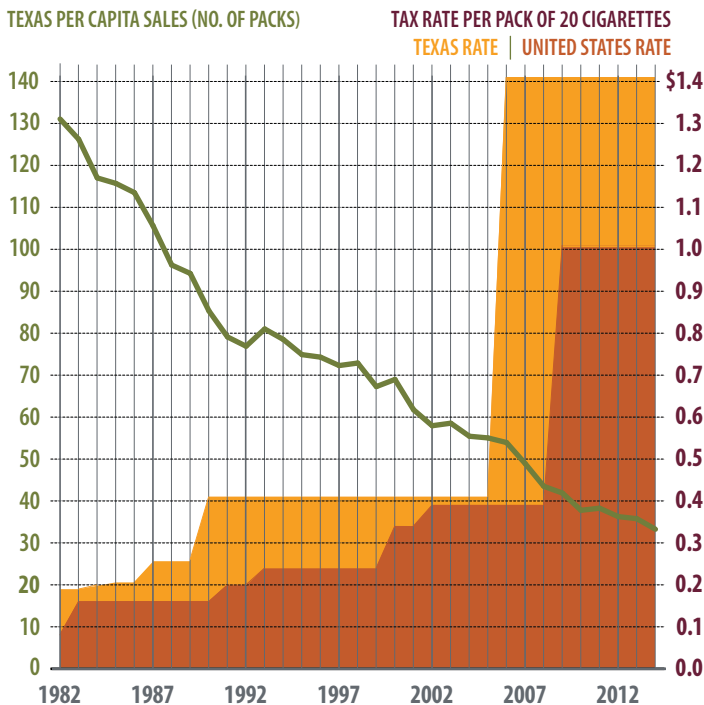
In the meantime, Texans’ sin taxes continue to add revenue to state coffers. While it’s unclear whether they’ll ever succeed in curbing our appetite for tobacco, alcohol and gambling, at least state services benefit from our vices.

For more information on Texas taxes, visit Comptroller.Texas.Gov. **FN**

EXHIBIT 6













CIGARETTE TAX RATES COMPARED TO PER CAPITA SALES

1982-2014



Sources: Federation of Tax Administrators and Texas Comptroller of Public Accounts

EXHIBIT 7

OVERVIEW OF TEXAS "SIN" TAXES				
	TAX	RATE AND BASE	REMITTED BY:	FISCAL 2015 REVENUE
	AIRLINE/PASSENGER TRAIN BEVERAGE TAX (REPEALED 2015)	5 cents per serving of an alcoholic beverage	Businesses providing commercial airline and passenger train service	\$328,081
	BEER TAX	\$6 per 31 gallon barrel (19.4 cents per gallon)	Beer distributors, manufacturers and brew pubs	\$103,006,928
	CIGAR AND TOBACCO PRODUCTS TAX	1 cent per 10 cigars weighing 3 lbs per 1,000 cigars or less; \$7.50-\$15.00 per 1,000 cigars weighing more than 3 lbs per 1,000, depending on factory price and amount of non-tobacco ingredients; \$1.22 per 1 ounce of chewing, pipe or roll-your-own tobacco and snuff	Cigar and tobacco wholesale distributors	\$225,848,250
	CIGARETTE TAX	\$70.50 per 1,000 cigarettes weighing 3 lbs or less (\$1.41 per pack of 20); \$72.60 per 1,000 weighing more than 3 lbs	Cigarette wholesale distributors	\$1,306,566,017
	CONTROLLED SUBSTANCE TAX (REPEALED 2015)	\$200 for each gram of a controlled substance; \$3.50 for each gram of marijuana; \$200/gram or \$2,000 for each 50 dosages of a controlled substance not sold by weight	Distributors of four or more ounces	\$7,359
	LIQUOR TAX	\$2.40 per gallon	Liquor wholesalers	\$84,132,759
	STATE LOTTERY	N/A	N/A	\$1,152,813,557*
	MALT LIQUOR (ALE) TAX	19.8 cents per gallon	Malt liquor (ale) wholesalers	\$14,415,305
	MIXED BEVERAGE GROSS RECEIPTS TAX AND MIXED BEVERAGE SALES TAX	6.7 percent of the gross receipts from alcoholic beverage sales; 8.25 percent on the sale of alcoholic beverages	Permitted sellers of mixed drinks (gross receipts) and consumers (sales)	\$922,120,847
	PARI-MUTUEL RACING	N/A	N/A	\$2,996,492
	SEXUALLY ORIENTED BUSINESS FEE	\$5 per patron of establishments that host live nude shows and also allow alcohol consumption on their premises	Establishment owners	\$8,946,384
	WINE TAX	20.4 cents per gallon for alcoholic volume not over 14 percent; 40.8 cents per gallon for alcoholic volume over 14 percent; 51.6 cents per gallon for sparkling wine	Wine wholesalers, wineries	\$14,771,656

* Transfers to Foundation School Program.
Source: Texas Comptroller of Public Accounts

“Setting Aside” Money for College

by Maria Garnett

HOW TEXAS FUNDS STUDENT AID



The spiraling cost of a college education — and the debt accompanying it — is on Americans’ minds now more than ever. Students and their families have seen their tuition bills skyrocket, threatening the dream of college for many.

Texas has invested in public higher education since the 19th century, through the establishment of the University of Texas and what would become Texas A&M University, as well as the creation of the Permanent University Fund, which generates investment income for both university systems.

Nevertheless, Texas was a “low-cost, low-aid” state in terms of public higher education until the latter part of the 20th century. The state established its first major grant program for higher education in 1973, with the creation of Tuition Equalization Grants, which provide need-based financial aid to Texas residents attending private nonprofit universities, traditionally much more expensive than public institutions.

Students attending the state’s public colleges and universities received similar need-based assistance in 1975, with the introduction of Texas Public Educational Grants (TPEGs). Texas funds TPEGs by setting aside a portion of the tuition collected at public institutions for this purpose. Thus, Texas’ primary aid source for students at public institutions comes through what is commonly called a *financial aid set-aside* or simply a *set-aside*.

The 2003 Legislature’s H.B. 3015 “deregulated” public tuition, significantly changing the financial landscape for public universities and their students.

Nearly 25 years later, in 1999, the state of Texas created another need-based financial aid program, TEXAS Grants (Towards Excellence, Access and Success), funded through legislative appropriations.

While these relatively modest initiatives fit well with Texas’ low-cost, low-aid model, that model was pushed to a breaking point during a state budgetary shortfall in 2003. In that year, the Legislature passed H.B. 3015, which “deregulated” public tuition, significantly changing the financial landscape for Texas public universities and the students attending them.

TUITION DEREGULATION AND SET-ASIDES

Prior to 1997, the Texas Legislature set all tuition rates for Texas public universities. The Legislature continues to set the rate for a portion of total tuition called statutory tuition, currently \$50 per semester credit hour (SCH) for Texas residents, with higher rates for nonresidents. Fifteen percent of statutory tuition is set aside for the TPEG program.

In 1997, however, the Legislature added a second type of tuition for undergraduates at public universities, designated tuition. (A third type, board-authorized tuition, is charged for graduate courses.) Designated tuition rates are set by university governing boards and thus vary by institution.

Before 2003, the state placed caps on both statutory and designated tuition. H.B. 3015 deregulated designated tuition, allowing university boards to raise rates beyond a previous cap of \$46 per SCH. The Legislature continued to set rates for statutory tuition.

To offset anticipated increases in designated tuition, H.B. 3015 also required the expansion of financial aid set-asides at Texas public universities. The Legislature kept in place the 15 percent set-aside of statutory tuition to fund financial aid, but instituted a 20 percent set-aside requirement for any increases to designated tuition above the previous cap. (The former \$46 cap is still used to calculate the set-aside today.)

The 20 percent set-aside included 15 percent for need-based financial aid at each university; the remaining 5 percent was used to fund a “B-On-Time” loan program, offering qualified students zero-interest loans that would be forgiven if they graduated on time.

SET-ASIDES RISE WITH TUITION

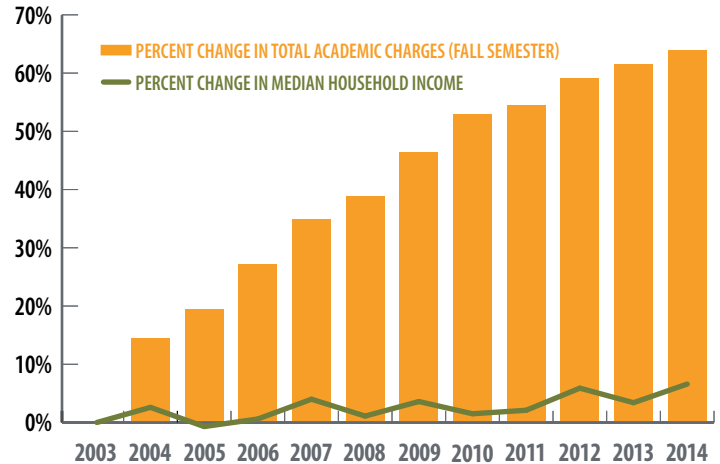
Since 2003, tuition and fees at Texas public universities have increased enormously in real terms, while median household income has grown only minimally (**Exhibit 1**).

The impact of tuition deregulation has differed greatly by institution, however. Among Texas public institutions that existed in 2003, designated tuition increases from Fall 2003 to Fall 2014 ranged from less than 139 percent at Texas A&M University – Kingsville to nearly 363 percent at the University of Texas at Dallas (**Exhibit 2**).

EXHIBIT 1

TEXAS MEDIAN HOUSEHOLD INCOME VS. AVERAGE TOTAL ACADEMIC CHARGES AT TEXAS PUBLIC UNIVERSITIES

2003-2014 School Years
(Adjusted for Inflation to 2014 Dollars)



Sources: U.S. Census Bureau, U.S. Bureau of Labor Statistics and Texas Comptroller of Public Accounts

As the amounts universities charge in designated tuition rose, so did the amount of tuition set-asides for financial aid (**Exhibit 3**). Set-asides from designated tuition grew from a statewide average of \$2.55 per SCH in Fall 2004 to \$19.18 per SCH in Fall 2014, an increase of nearly 654 percent.

Financial aid set-asides from statutory tuition also increased over this period, though much more modestly, in line with increases to statutory tuition

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EXHIBIT 2

RANGE OF INCREASES IN DESIGNATED TUITION, TEXAS PUBLIC UNIVERSITIES

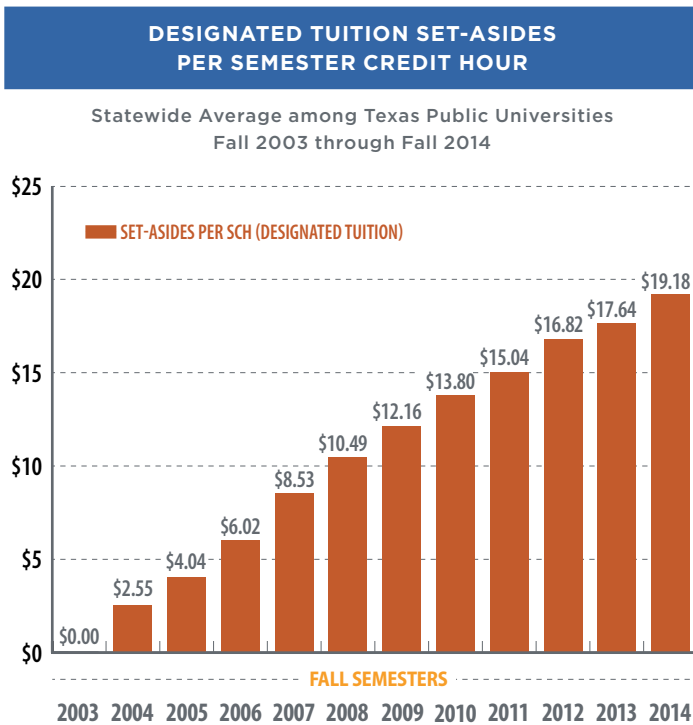
FALL 2003 TO FALL 2014

INCREASE	NUMBER/SHARE OF INSTITUTIONS	INSTITUTIONS
≥ 131.8 < 200 percent	10; 29.4 percent	Texas A&M University (TAMU)-Kingsville; TAMU-Corpus Christi; TAMU-Commerce; Angelo State University; University of Houston-Victoria; University of Texas (UT)-Tyler; Tarleton State University; UT-Permian Basin; University of Houston-Clear Lake; UT-El Paso
≥ 200 < 300 percent	16; 47.1 percent	TAMU-International; Texas Woman’s University; Midwestern State University; UT-Brownsville; UT-San Antonio; University of Houston-Downtown; TAMU-Texarkana; Texas Tech University; Texas Southern University; UT-Pan American; TAMU (College Station); West TAMU; UT-Austin; Sul Ross State University; Sam Houston State University; TAMU-Galveston
≥ 300 percent	8; 23.5 percent	Prairie View A&M; Texas State University; University of North Texas; Stephen F. Austin State University; Lamar University; UT-Arlington; University of Houston; UT-Dallas

Note: Of 37 Texas public universities, three were not in operation in Fall 2003 and therefore are excluded from this analysis: Texas A&M University – Central Texas, Texas A&M University – San Antonio and the University of North Texas at Dallas. UT-Brownsville and UT-Pan American, which are merging to form UT-Rio Grande Valley, are treated as separate institutions for this purpose.

Sources: Texas Higher Education Coordinating Board and Texas Comptroller of Public Accounts

EXHIBIT 3



Sources: Texas Higher Education Coordinating Board and Texas Comptroller of Public Accounts

itself. Statutory tuition per SCH (and thus the set-asides funding the Texas Public Educational Grant program) has increased only twice in the past 12 years, from \$46 to \$48 in Fall 2004, and to \$50 in Fall 2005. The 15 percent of statutory tuition reserved for TPEGs therefore has risen from \$6.90 per SCH in Fall 2003 to \$7.50 at present.

During the 2015 session of the Texas Legislature, lawmakers passed H.B. 700, which will phase out the B-On-Time loan program by 2020, and eliminated its accompanying 5 percent set-aside for designated tuition beginning in Fall 2015.

At present, then, the same set-aside percentage applies to both statutory and designated tuition, with the 15 percent designated set-aside exclusively funding institutional aid programs.

Universities have been required to notify students of the set-asides generated via their tuition payments since 2009, though they are able to do so in a variety of ways, such as statements on tuition bills or emails sent to individual students.

SET-ASIDES AND THE COST OF COLLEGE

As detailed in a December 2014 Comptroller special report, there are multiple potential explanations for the steep rise in the cost of higher education; the use of tuition set-asides is hardly the only reason.

But that’s not to say it has no effect. The set-aside requirement for designated tuition could be contributing to the price increase by leading public universities to charge higher tuition rates than they would in the absence of the requirement.

The reason is fairly simple. As things stand, universities get only 85 percent of the “benefit” of a tuition increase, due to the set-aside. Thus a university seeking an additional \$100 in tuition per student to meet its costs must increase its tuition by nearly \$118.

ALTERNATIVES TO SET-ASIDES?

While the general public, and even students at Texas public universities, may be largely unaware of the role financial aid set-asides play in higher education, some groups *have* been paying attention, and support the repeal of the set-asides mandate. The elimination of the 5 percent set-aside for the B-On-Time program may encourage such efforts.

One alternative to mandatory set-asides is to expand the grant programs Texas already has in place, such as the TEXAS Grants, which received additional funding in the 2015 legislative session. If the goal is to subsidize public higher education for students with financial need, the logic runs, why rely upon the relatively small pool of students and their families rather than the broader Texas tax base?

Based on data provided by the Texas Higher Education Coordinating Board, for instance, undergraduate set-asides in 2012 came from 454,154 students paying an average of \$649 each. If the state had provided this amount directly, it would have cost Texans a little more than \$11 each to generate the same amount of funding. Given the existing infrastructure of the TEXAS Grant program, administrative costs would be minimal.

On the other hand, the political costs of increasing state spending, even toward the goal of ensuring higher education affordability, might prove too great to overcome.

The rising cost of college is a complex issue, but one with significant economic consequences for students, families and our state in general. Now that at least part of Texas’ required set-asides have been eliminated, it seems likely the Legislature will examine the entire system more closely, sooner or later. **FN**

Microfinance Makes Big Impact

by Jackie Benton



The SBA makes funding available to specially designated intermediary lenders with nonprofit status and experience in lending and technical assistance. These lenders then make loans to eligible borrowers, at competitive interest rates, in amounts up to \$50,000. The average loan size is about \$13,000. Applications are submitted to the designated local intermediary lender, and all credit decisions are made on the local level.

In addition to federal funding, some microlenders receive support from public-private partnerships. San Antonio's 80/20 Foundation, founded by Rackspace Hosting's chairman Graham Weston, invests in nonprofit organizations such as LiftFund with the intent of growing

SMALL LOANS HELP BUSINESS GROW

Many South Texas residents may never have heard of one of their region's busiest business lending institutions. But for nonprofit "microfinance" lender LiftFund (formerly known as Acción Texas) and other nonprofit lenders, small business is good business — and great news for one of Texas' most economically challenged regions.

Microfinance "is a universal term for providing small loans, either for consumers or businesses, to those who cannot access debt from traditional financial services like a bank or credit card," says Celina Peña, chief program officer for LiftFund, the state's largest microfinance lender. "It combats predatory lending and can assist individuals in building assets and becoming part of the American financial mainstream."

Even before the Great Recession, small entrepreneurs needing startup capital faced difficulties. Since then, mainstream institutions have tightened their lending requirements — and often view small business owners as particularly risky bets. But microlenders across the U.S. are helping to fill the gap.

FUNDING AND ASSISTANCE

With assistance from the U.S. Small Business Administration (SBA), Texas microloan entities such as LiftFund, PeopleFund, New Covenant Capital Corporation, BCL of Texas and the Alliance for Multicultural Community Services are becoming more familiar to the state's small business community.

small businesses that will improve the local quality of life and encourage larger companies to relocate to Texas.

The El Paso Small Business Development Center (SBDC) works in conjunction with LiftFund to assist most of its clients seeking microloans.

"The SBDC provides the majority of the technical assistance required by LiftFund," says Joseph C. Ferguson, director of the El Paso SBDC. This may take the form of one-on-one confidential business advising, project feasibility analysis and business planning.

"Quite often, the loan applicant will need assistance in properly completing the loan application," he says. "The applicant will also be schooled in understanding business financial statements. All of these services are provided at no cost to the applicant in either English or Spanish. Upon completion of the assistance provided by the SBDC, the applicant is referred back to LiftFund for project review and underwriting analysis."

Ferguson also says the SBDC's role is only to facilitate the microloan process — his organization does not make or guarantee any loan. If LiftFund decides to assist a client with an SBA guaranteed loan, SBDC helps the applicant with the required documentation and other technical assistance.

CONTINUED ON PAGE 12



CELINA PEÑA
CHIEF PROGRAM OFFICER,
LIFTFUND

HELP ALONG THE BORDER

Microfinance can be particularly crucial in the Border region.

"The challenges that small businesses located along the Border face in obtaining startup and expansion financing are quite different than those of larger businesses," Ferguson says. "It's not unusual for a small

business owner to be unfamiliar with business financing. Many owners started their businesses with saved money or seed capital provided by other family members."

Ferguson also notes that a lack of business education is a common denominator among microloan borrowers.

"Instead of their goal being to create and grow a business, it is usually more about creating a job for themselves," he says. "Many of the owners only have a trade or skill that they've turned into a business, [but] traditional lenders often want

a formal business education or years of experience. They also lack the basic requirements for a traditional bank loan. Technical assistance is needed to create a brief business plan, financial projections and possibly even help in creating the prior year's financial statements."

"Microfinance use along the border is vital to individuals who are just not able to receive traditional financing," says LiftFund's Peña. "When you think of the Border economy, you get a sense of the poverty, but also the tremendous amount of commerce. Our work complements this environment very well."

The Border region is unlike other regions in Texas, agrees Rosa Rios Valdez, president and CEO of microlender BCL of Texas. "South Texas borrowers don't have MBAs — they typically don't even have high school diplomas. Their credit scores are lower, and most don't have enough history as an operating business. They're intimidated filling out a traditional bank application, because they don't feel a bank is welcoming their business."

Another issue for borrowers in the Border region, says Rios Valdez, is collateral. "A lot of the collateral these businesses have to offer is not bankable," she explains. "These are small businesses that don't have big plans for market penetration. The assets they have to offer as collateral are not what a bank would be interested in. If your business is making tamales, would a bank consider your tamales, or the equipment used to make them, adequate collateral for a loan?"



JOSEPH C. FERGUSON

DIRECTOR, EL PASO
SMALL BUSINESS
DEVELOPMENT CENTER



In addition to federal funding, some microlenders receive support from public-private partnerships.

TAILOR-MADE LOANS

Fortunately for borrowers, microlenders look at other criteria to determine if an applicant's loan is approved.

"We look at cash flow and the experience the borrowers have in their industry or management," says Rios Valdez. "To us, it doesn't matter if you have a degree or not, it comes down to, 'Do you have the experience managing business in that industry?' If you're going to make tamales, did you supervise the production area, did you work in placing orders, are you aware of your monthly and quarterly sales? We do look at collateral, but we're flexible on that. We look at financial projections for the business: does it have a track record? What has been the cash flow in the past, and can this business support new debt now?"

LiftFund, based in San Antonio, provided nearly \$57 million to small businesses and entrepreneurs in South Texas between 1996 and 2014 (**Exhibit 1**). It provides loans ranging from \$500 to \$50,000 for a period of no more than five years.

EXHIBIT 1

HELPING SMALL BUSINESS THRIVE IN SOUTH TEXAS

LiftFund Lending in South Texas, 1996 - October 2014

Through 2014, LiftFund (formerly Acción Texas) provided small businesses and individual entrepreneurs in South Texas with nearly \$57 million in loans.

LIFTFUND OFFICE	TOTAL LOANS	TOTAL AMOUNT DISBURSED
Rio Grande Valley – Brownsville, Harlingen, McAllen and surrounding cities (established 1998)	1,535	\$19,460,359
Laredo (established 2005)	443	\$5,324,609
Corpus Christi (established 2004)	693	\$10,191,450
El Paso (established 1996)	1,984	\$21,866,844
Total	4,655	\$56,843,262

Source: LiftFund

Since 1996, it has built on its success in South Texas by expanding throughout Texas and the Southeastern U.S., allowing LiftFund to service clients in Alabama, Arkansas, Kentucky, Louisiana, Mississippi, Missouri and Tennessee.

Clients repay LiftFund more than 90 percent of the time. The organization credits its high repayment rates to a risk model it uses to select the most promising clients.

“We revise our formula every two years,” says Peña. “It’s an important element of our success. It helps folks understand we’re not making decisions based on what’s in front of us only, but based on our track record and theirs.”

Of course, not every application is approved. According to Peña, the care with which microlenders choose their customers sets them apart from traditional lenders.

“We want to be able to support them,” she says of those denied loans. “You can reapply in 90 days if you’ve taken certain measures to improve your financial status, and we provide guidance and partner resources.”

TEACHING SUCCESS

Many microfinance institutions offer their customers financial education and vocational training to encourage self-reliance and financial discipline.

LiftFund, for instance, encourages clients to take advantage of its free financial educational classes.

“Our education focuses around financial management,” says Peña. “You can go to school now to become a business owner, but most of our clients didn’t take that route.”

Many microfinance institutions offer their customers financial education and vocational training, to encourage self-reliance and financial discipline.

The nonprofit provides would-be applicants with tips on finding funding and other steps involved in starting a business. It also collaborates with other community organizations to develop a 360-degree understanding of its clients’ needs.

“While microlending is not traditional, it’s a step into the financial mainstream,” says Peña. “Someone can have a budget, but not really understand why they’re at a negative cash flow. Or they didn’t realize they had a low credit score because of something that happened three years ago.”

Most of all, Peña says, LiftFund wants its clients to understand basic finance and lending principles as they begin to become entrepreneurs.

“We want people to understand where they are financially,” Peña says. “The loan is a vital tool, but so many other things go with that.”

“When you’re in the business you’re in that mindset — you’ve got your blinders on to get business done, so having someone outside the business looking at it financially is pretty eye-opening,” she says.

CONTINUED ON PAGE 14



BUILDING SOLID COMMUNITY ASSETS

BCL's Rios Valdez says her institution's lending philosophy takes a larger view of what small business can do to strengthen the economy of its community at large. Rios Valdez calls this sort of community asset building the "ripple effect."

"It's not just about starting a microbusiness and you've created jobs for yourself and your spouse," she says. "The whole idea of stimulating the economy is beyond having received a loan and making a nice business just for yourself. When we interview our borrowers, we ask them several questions such as, 'Do you offer your employees benefits?'"

"We want our microbusinesses to create jobs at a livable wage, which is considered \$10.10 an hour," Rios Valdez explains. "We want to look at the financial capability of the business, and its employees' financial ability to own a home and have a comfortable life."

"When BCL works with a microbusiness, we want to help them grow to the next level, and get the owners to understand the importance of asset building for themselves and their employees," she says.

COMMUNITY COLLABORATION

LiftFund is working to increase its lending and make larger loans that would allow it to break even on its business loans.

"Most banks use credit cards to provide capital for small business, because business loans don't make money below a certain threshold," Peña says. "LiftFund doesn't make money on loans under \$15,000. As a nonprofit, we're always trying to figure out how we crack that nut. Our average loan size is \$14,000 — we're almost there."

Peña feels LiftFund's future success lies in partnering with the communities it serves, bringing key partners and community leaders together to plan for solid business development in their areas.

As proof of the success partnership can bring, Ferguson points to the wide variety of

businesses in the El Paso region that have benefited from the joint assistance they have received from SBDC and LiftFund.

"These businesses range from restaurants, used car dealers, driver training schools, HVAC companies, owner-operated trucking companies, flower shops and contractors, to name a few," says Ferguson. "As diverse as they are, they all had one thing in common: for various reasons, they were unable to obtain financing through traditional lenders. Without the assistance of LiftFund and the SBDC, these businesses probably wouldn't exist."

"We recognize we can't do this work alone," agrees Peña. "It takes many players, and I think that's one of our strengths in South Texas, working with others." **FN**

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Glenn Hegar
Texas Comptroller of Public Accounts

Comments or complaints may be mailed to the following address or by calling the following number: Prepaid Higher Education Tuition Program, Office of the Comptroller of Public Accounts, P.O. Box 13407, Austin, Texas 78711-3407, 512-936-2064.

State Revenue Watch

This table presents data on net state revenue collections by source. It includes most recent monthly collections, year-to-date (YTD) totals for the current fiscal year and a comparison of current YTD totals with those in the equivalent period of the previous fiscal year.

These numbers were current at press time. For the most current data as well as downloadable files, visit TexasTransparency.org.

Note: Texas' fiscal year begins on September 1 and ends on August 31.

NET STATE REVENUE — All Funds Excluding Trust

(AMOUNTS IN THOUSANDS)

Monthly and Year-to-Date Collections: Percent Change From Previous Year

Tax Collections by Major Tax	SEPTEMBER 2015	YEAR TO DATE: TOTAL	YEAR TO DATE: CHANGE FROM PREVIOUS YEAR
SALES TAX	\$2,221,358	\$2,221,358	1.87%
PERCENT CHANGE FROM SEPTEMBER 2014	1.87%		
MOTOR VEHICLE SALES AND RENTAL TAXES	\$415,958	\$415,958	5.75%
PERCENT CHANGE FROM SEPTEMBER 2014	5.75%		
MOTOR FUEL TAXES	\$308,267	\$308,267	5.30%
PERCENT CHANGE FROM SEPTEMBER 2014	5.30%		
FRANCHISE TAX	\$(32,336)	\$(32,336)	2458.59%
PERCENT CHANGE FROM SEPTEMBER 2014	2458.59%		
INSURANCE TAXES	\$15,584	\$15,584	-17.05%
PERCENT CHANGE FROM SEPTEMBER 2014	-17.05%		
NATURAL GAS PRODUCTION TAX	\$69,099	\$69,099	-62.35%
PERCENT CHANGE FROM SEPTEMBER 2014	-62.35%		
CIGARETTE AND TOBACCO TAXES	\$65,292	\$65,292	-51.57%
PERCENT CHANGE FROM SEPTEMBER 2014	-51.57%		
ALCOHOLIC BEVERAGES TAXES	\$94,313	\$94,313	2.35%
PERCENT CHANGE FROM SEPTEMBER 2014	2.35%		
OIL PRODUCTION AND REGULATION TAXES	\$160,951	\$160,951	-54.97%
PERCENT CHANGE FROM SEPTEMBER 2014	-54.97%		
UTILITY TAXES¹	\$981	\$981	22.96%
PERCENT CHANGE FROM SEPTEMBER 2014	22.96%		
HOTEL OCCUPANCY TAX	\$44,096	\$44,096	1.09%
PERCENT CHANGE FROM SEPTEMBER 2014	1.09%		
OTHER TAXES²	\$7,873	\$7,873	-49.07%
PERCENT CHANGE FROM SEPTEMBER 2014	-49.07%		
TOTAL TAX COLLECTIONS	\$3,371,436	\$3,371,436	-9.18%
PERCENT CHANGE FROM SEPTEMBER 2014	-9.18%		
Revenue By Source			
TOTAL TAX COLLECTIONS	\$3,371,436	\$3,371,436	-9.18%
PERCENT CHANGE FROM SEPTEMBER 2014	-9.18%		
FEDERAL INCOME	\$3,086,215	\$3,086,215	3.31%
PERCENT CHANGE FROM SEPTEMBER 2014	3.31%		
LICENSES, FEES, PERMITS, FINES AND PENALTIES	\$821,127	\$821,127	29.74%
PERCENT CHANGE FROM SEPTEMBER 2014	29.74%		
INTEREST AND INVESTMENT INCOME	\$40,652	\$40,652	8.07%
PERCENT CHANGE FROM SEPTEMBER 2014	8.07%		
LOTTERY PROCEEDS³	\$175,464	\$175,464	29.18%
PERCENT CHANGE FROM SEPTEMBER 2014	29.18%		
SALES OF GOODS AND SERVICES	\$21,692	\$21,692	-9.89%
PERCENT CHANGE FROM SEPTEMBER 2014	-9.89%		
SETTLEMENTS OF CLAIMS	\$6,789	\$6,789	299.44%
PERCENT CHANGE FROM SEPTEMBER 2014	299.44%		
LAND INCOME	\$101,313	\$101,313	-52.15%
PERCENT CHANGE FROM SEPTEMBER 2014	-52.15%		
CONTRIBUTIONS TO EMPLOYEE BENEFITS	\$3	\$3	-38.97%
PERCENT CHANGE FROM SEPTEMBER 2014	-38.97%		
OTHER REVENUE SOURCES	\$241,148	\$241,148	67.98%
PERCENT CHANGE FROM SEPTEMBER 2014	67.98%		
TOTAL NET REVENUE	\$7,865,840	\$7,865,840	-0.26%
PERCENT CHANGE FROM SEPTEMBER 2014	-0.26%		

1 Includes public utility gross receipts assessment, gas, electric and water utility tax and gas utility pipeline tax.

2 Includes the cement and sulphur taxes and other occupation and gross receipt taxes not separately identified.

3 Gross sales less retailer commissions and the smaller prizes paid by retailers.

Note: Totals may not add due to rounding.



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