



Section Two
(continued)

Management's Discussion and Analysis

Management's Discussion and Analysis

The following is a discussion and analysis of the state of Texas' financial performance for the fiscal year ended Aug. 31, 2012. Use this section in conjunction with the state's basic financial statements. Comparative data is available and presented for this 2012 report.

Highlights

Government-wide

Net Position

The assets of the state of Texas exceeded its liabilities by \$148.6 billion as of Aug. 31, 2012, an increase of \$9.2 billion or 6.6 percent from fiscal 2011. The majority of the increase is primarily due to an increase of \$3.6 billion in nonexpendable funds. The net position is comprised of \$73.2 billion in capital assets, net of related debt, \$61.3 billion in restricted, and \$14.1 billion in unrestricted.

Fund Level

Governmental Funds

As of Aug. 31, 2012, the state's governmental funds reported a combined ending fund balance of \$44.2 billion, an increase of \$2.1 billion or 5 percent from fiscal 2011, primarily due to an increase in tax revenues. The state reported a positive unassigned fund balance of \$583.6 million in fiscal 2012.

Proprietary Funds

The proprietary funds reported a net position of \$46.8 billion as of Aug. 31, 2012, an increase of \$4.7 billion or 11.1 percent from fiscal 2011, primarily due to an increase in the valuation of investments.

Long-Term Debt

The state's total bonds outstanding decreased by \$843.3 million or 2.2 percent during fiscal 2012, primarily due to a restatement for bonds determined to

be conduit debt. This amount represents the net difference between net issuances, payments and refundings of outstanding bond debt. During fiscal 2012, the state issued bonds totaling \$2.2 billion. More detailed information regarding the government-wide, fund level and long-term debt activities can be found in the debt administration section of this management's discussion and analysis (MD&A).

Overview of the Financial Statements

The focus of this report is on reporting for the state as a whole and on the major individual funds. The report presents a more comprehensive view of the state's financial activities and makes it easier to compare the performance of Texas state government to that of other governments.

The Financial Section of this annual report presents the state's financial position and activities in four parts:

- MD&A (this part)
- The basic financial statements
- Required supplementary information other than MD&A
- Other supplementary information presenting combining statements and schedules

The report also includes statistical and economic data.

The basic financial statements include government-wide financial statements, fund financial statements and notes to financial statements, which provide more detailed information to supplement the basic financial statements.

Reporting on the State as a Whole

The government-wide financial statements are designed to present an overall picture of the financial position of the state. These statements consist of the statement of net position and the statement of activities, which are prepared using the economic resources mea-

surement focus and the accrual basis of accounting. This means that all the current year's revenues and expenses are included, regardless of when cash is received or paid, producing a view of financial position similar to that presented by most private sector companies.

The statement of net position combines and consolidates the government's current financial resources with capital assets and long-term obligations. This statement includes all of the government's assets, deferred outflows, liabilities and deferred inflows.

Net position represents one measure of the state's financial health.

Other indicators of the state's financial health include the condition of its roads and highways (infrastructure) and economic trends affecting the state's future tax revenues.

The statement of activities focuses on both the gross and net cost of various activities (governmental, business-type and component units). These costs are paid by the state's general tax and other revenues. This statement summarizes the cost of providing (or the subsidy provided by) specific government services and includes all current year revenues and expenses.

The government-wide statement of net position and the statement of activities divide the state's activities into the following three types.

Governmental Activities

The state's basic services are reported here, including general government; education; employee benefits; teacher retirement state contributions; health and human services; public safety and corrections; transportation; natural resources and recreation; and regulatory services. Taxes, fees and federal grants finance most of these activities.

Business-Type Activities

Activities for which the state charges a fee to customers to pay most or all of the costs of certain services

it provides are reported as business-type activities. The state's institutions of higher education are included as business-type activities.

Component Units

Component units are legally separate organizations for which the state is either financially accountable or the nature and significance of their relationship with the state is such that exclusion would cause the state's financial statements to be misleading or incomplete. The state has 26 discretely presented component units. Financial information for these entities is presented separately in the supplemental statements and in the notes.

Reporting on the State's Most Significant Funds

Fund financial statements provide additional detail about the state's financial position and activities. Some information presented in the fund financial statements differs from the government-wide financial statements due to the perspective and basis of accounting used. Funds are presented on the fund-level statements as major or nonmajor based on criteria set by the Governmental Accounting Standards Board (GASB).

A fund is a separate accounting entity with a self-balancing set of accounts. The state uses funds to keep track of sources of funding and spending related to specific activities.

Governmental Funds

A majority of the state's activity is reported in governmental funds. Reporting of these funds focuses on the flow of money into and out of the funds and amounts remaining at fiscal year-end for future spending.

Governmental funds are accounted for using the modified accrual basis of accounting, which measures cash and other assets that can be readily converted to cash. The governmental fund financial statements

provide a detailed short-term view of the state's general governmental operations and the basic services it provides. This information helps determine the level of resources available for the state's programs. The reconciliations following the fund financial statements explain the differences between the governmental activities column reported on the government-wide statement of net position and the government-wide statement of activities, and the governmental funds reported on the fund financial statements. The general fund, state highway fund and permanent school fund are reported as major governmental funds.

Proprietary Funds

When the state charges customers for services it provides, these activities are generally reported in proprietary funds. Services provided to outside (non-governmental) customers are reported in enterprise funds, a component of proprietary funds, and are accounted for using the economic resources measurement focus and the accrual basis of accounting. These are the same business-type activities reported in the government-wide financial statements, but are reported here to provide information at the fund level.

The employees life, accident and health insurance benefits fund is reported as an internal service fund and provides services on a cost reimbursement basis to other agencies of the financial reporting entity.

Colleges and universities, the unemployment trust fund and the lottery fund are reported as major proprietary funds.

Reporting on the State's Fiduciary Responsibilities

The state is the trustee or fiduciary for six defined benefit plans and one defined contribution plan. It is also responsible for other assets that can be used only for trust beneficiaries. All state fiduciary activities are reported in separate statements of fiduciary net position

and changes in fiduciary net position. The activities are reported separately from other financial activities because the state cannot use the assets to finance its operations. The state's fiduciary responsibilities include ensuring that the assets reported in these funds are used for their intended purposes.

Financial Analysis of the State as a Whole

Net Position

Total assets of the state as of Aug. 31, 2012, were \$231.4 billion, an increase of \$19.5 billion or 9.2 percent. Total liabilities as of Aug. 31, 2012, were \$83.6 billion, an increase of \$10.5 billion or 14.3 percent. Net position was affected by a number of factors. Cash and cash equivalents increased by \$10.1 billion from fiscal 2011 and noncurrent investments increased by \$5.2 billion. Net capital assets increased by \$3.9 billion. The major components of this increase were additions to the state's highway system, and college and university building and building improvement projects. Current liabilities increased by \$9 billion, primarily due to the issuance of \$9.8 billion in tax and revenue anticipation notes in the latter part of fiscal 2012. There was an increase in net pension obligation of \$1.2 billion as well. The state's bonded indebtedness was \$37.9 billion, which included new issuances of \$2.2 billion in state bonds to finance new construction, housing, water conservation and other projects. Approximately \$2 billion in bonded debt was retired or refunded. Net position was \$148.6 billion as of Aug. 31, 2012, an increase of \$9.2 billion or 6.6 percent. Of the state's net position, \$73.2 billion was invested in capital assets, net of related debt, while \$61.3 billion was restricted by the Texas Constitution or other legal requirements and was not available to finance day-to-day operations of the state. Unrestricted net position was \$14.1 billion. The majority of the net position increase is primarily due to an increase of \$3.6 billion in nonexpendable funds.

Statement of Net Position

August 31, 2012 and 2011 (Amounts in Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2012	2011	2012	2011	2012	2011
ASSETS						
Assets Other Than Capital Assets	\$ 67,569,392	\$ 56,993,151	\$ 61,025,689	\$ 56,082,589	\$ 128,595,081	\$ 113,075,740
Capital Assets	78,448,782	75,667,494	24,343,466	23,189,842	102,792,248	98,857,336
Total Assets	<u>146,018,174</u>	<u>132,660,645</u>	<u>85,369,155</u>	<u>79,272,431</u>	<u>231,387,329</u>	<u>211,933,076</u>
DEFERRED OUTFLOWS			773,010	575,740	773,010	575,740
LIABILITIES						
Current Liabilities	24,369,928	15,466,022	9,950,778	9,869,570	34,320,706	25,335,592
Noncurrent Liabilities	19,876,070	19,941,936	29,386,652	27,844,373	49,262,722	47,786,309
Total Liabilities	<u>44,245,998</u>	<u>35,407,958</u>	<u>39,337,430</u>	<u>37,713,943</u>	<u>83,583,428</u>	<u>73,121,901</u>
NET POSITION						
Invested in Capital Assets, Net of Related Debt	63,458,493	61,917,432	9,712,946	9,242,552	73,171,439	71,159,984
Restricted	33,748,497	32,013,661	27,539,111	24,376,167	61,287,608	56,389,828
Unrestricted	4,565,186	3,321,594	9,552,678	8,515,509	14,117,864	11,837,103
Total Net Position	<u>\$ 101,772,176</u>	<u>\$ 97,252,687</u>	<u>\$ 46,804,735</u>	<u>\$ 42,134,228</u>	<u>\$ 148,576,911</u>	<u>\$ 139,386,915</u>

Changes in Net Position

The state's net position as of Aug. 31, 2012, increased by \$9.2 billion. The state earned program revenues of \$82.1 billion and general revenues of \$47.9 billion, for total revenues of \$130 billion, a decrease of \$1.6 billion or 1.2 percent from fiscal 2011. The major components of this decrease were operating grants and contributions, which had a decrease of \$6 billion, and capital grants and contributions, with a decrease of \$2.5 billion. Federal revenues decreased \$7.6 billion and interest and investment income decreased \$1.4 billion. These decreases offset \$4.7 billion gains in tax revenues.

The expenses of the state were \$120.5 billion, a decrease of \$4.1 billion or 3.3 percent. The expense

fluctuations in governmental activities are largely attributable to education and to health and human services. Education had a decrease of \$2.5 billion, primarily due to reduced distribution to local school districts. In business-type activities there was a \$938.1 million decrease in the health and human services function, primarily due to reduced unemployment benefit payments.

Further discussion of results for changes in the state's financial condition follows in the analysis of the state's funds. Operating and capital grants and contributions decreased while tax collections increased, mostly due to sales tax collections. Education expenses for local school districts and unemployment benefit payments also decreased.

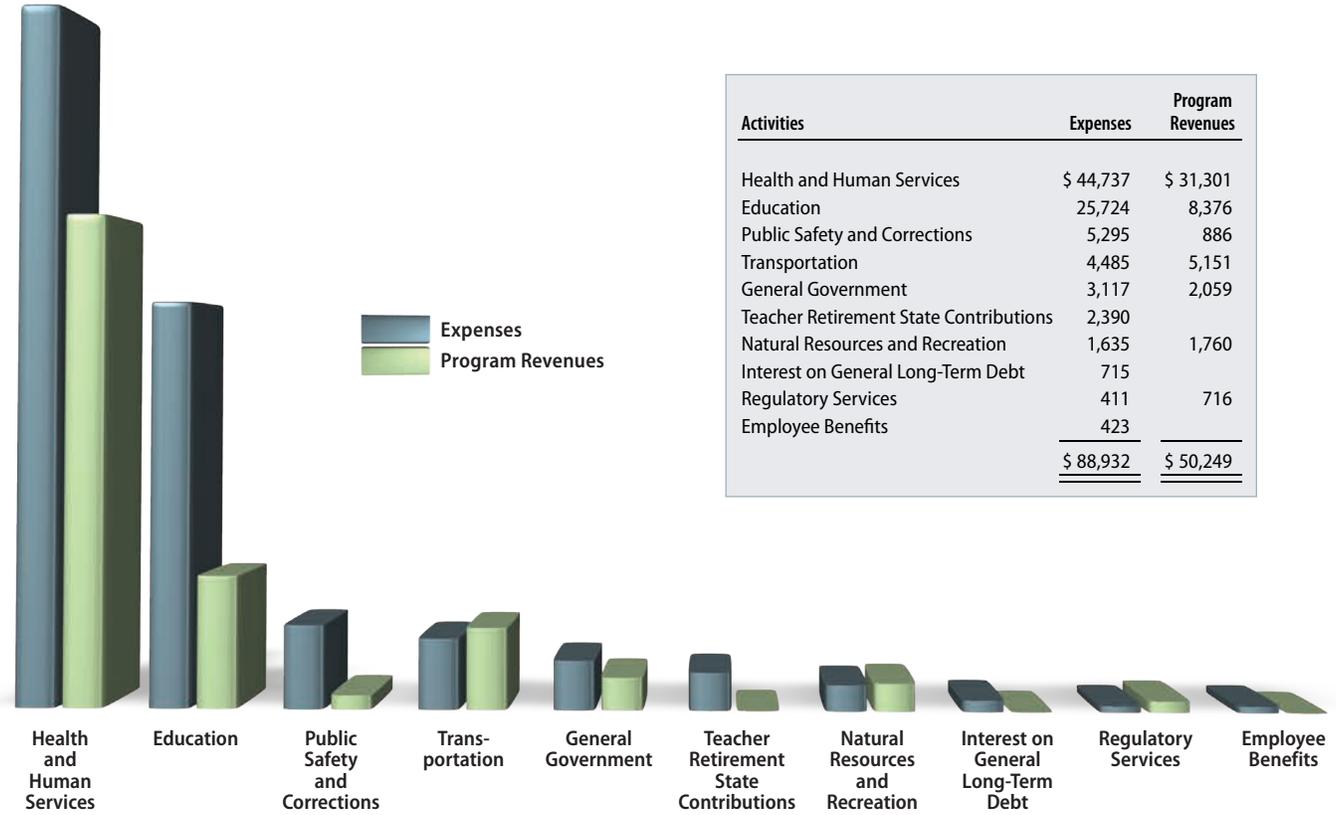
Changes in Net Position

For the Fiscal Years Ended August 31, 2012 and 2011 (Amounts in Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2012	2011	2012	2011	2012	2011
REVENUES						
Program Revenues:						
Charges for Services	\$ 7,405,088	\$ 7,337,119	\$ 19,037,312	\$ 17,682,518	\$ 26,442,400	\$ 25,019,637
Operating Grants and Contributions	42,796,231	47,220,463	12,542,912	14,103,243	55,339,143	61,323,706
Capital Grants and Contributions	47,578	2,538,949	259,750	281,741	307,328	2,820,690
Total Program Revenues	<u>50,248,897</u>	<u>57,096,531</u>	<u>31,839,974</u>	<u>32,067,502</u>	<u>82,088,871</u>	<u>89,164,033</u>
General Revenues:						
Taxes	44,338,553	39,661,587			44,338,553	39,661,587
Unrestricted Investment Earnings	645,813	334,621	133,680	86,295	779,493	420,916
Settlement of Claims	620,898	584,305	378	1,215	621,276	585,520
Gain on Sale of Capital Assets	7,163	99	543	1	7,706	100
Other General Revenues	1,880,352	1,533,427	248,725	222,640	2,129,077	1,756,067
Total General Revenues	<u>47,492,779</u>	<u>42,114,039</u>	<u>383,326</u>	<u>310,151</u>	<u>47,876,105</u>	<u>42,424,190</u>
Total Revenues	<u>97,741,676</u>	<u>99,210,570</u>	<u>32,223,300</u>	<u>32,377,653</u>	<u>129,964,976</u>	<u>131,588,223</u>
EXPENSES						
General Government	3,116,737	4,037,805	149,663	150,406	3,266,400	4,188,211
Education	25,724,127	28,643,283	22,667,292	22,226,690	48,391,419	50,869,973
Employee Benefits	423,492	324,477			423,492	324,477
Teacher Retirement State Contributions	2,390,178	2,262,638			2,390,178	2,262,638
Health and Human Services	44,737,457	44,875,285	5,117,829	6,055,958	49,855,286	50,931,243
Public Safety and Corrections	5,294,730	5,539,155	91,313	86,262	5,386,043	5,625,417
Transportation	4,484,662	4,377,794	215,845	209,880	4,700,507	4,587,674
Natural Resources and Recreation	1,634,659	1,474,675	346,150	423,140	1,980,809	1,897,815
Regulatory Services	410,724	408,115			410,724	408,115
Interest on General Long-Term Debt	715,148	797,030			715,148	797,030
Lottery			3,027,943	2,783,798	3,027,943	2,783,798
Total Expenses	<u>88,931,914</u>	<u>92,740,257</u>	<u>31,616,035</u>	<u>31,936,134</u>	<u>120,547,949</u>	<u>124,676,391</u>
Excess Before Contributions, Special Items and Transfers	<u>8,809,762</u>	<u>6,470,313</u>	<u>607,265</u>	<u>441,519</u>	<u>9,417,027</u>	<u>6,911,832</u>
Capital Contributions	930	108,119		3,045	930	111,164
Contributions to Permanent and Term Endowments			136,800	126,971	136,800	126,971
Transfers	(3,944,781)	(4,179,888)	3,944,781	4,179,888		
Change in Net Position	<u>4,865,911</u>	<u>2,398,544</u>	<u>4,688,846</u>	<u>4,751,423</u>	<u>9,554,757</u>	<u>7,149,967</u>
Net Position, Beginning Balance	97,252,687	94,905,088	42,134,228	37,371,790	139,386,915	132,276,878
Restatements	(346,422)	(50,945)	(18,339)	11,015	(364,761)	(39,930)
Net Position, Beginning Balance, as Restated	<u>96,906,265</u>	<u>94,854,143</u>	<u>42,115,889</u>	<u>37,382,805</u>	<u>139,022,154</u>	<u>132,236,948</u>
Net Position, Ending Balance	<u>\$ 101,772,176</u>	<u>\$ 97,252,687</u>	<u>\$ 46,804,735</u>	<u>\$ 42,134,228</u>	<u>\$ 148,576,911</u>	<u>\$ 139,386,915</u>

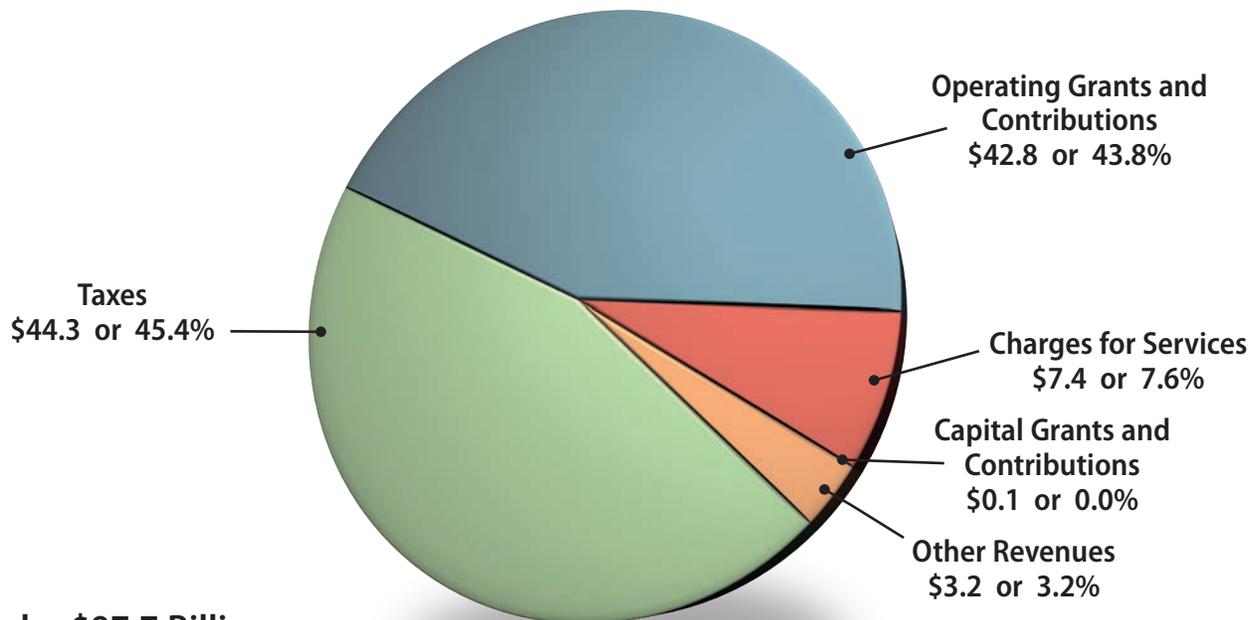
Expenses and Program Revenues: Governmental Activities

For the Fiscal Year Ended August 31, 2012 (In Millions)



Revenue by Source: Governmental Activities

For the Fiscal Year Ended August 31, 2012 (In Billions)*

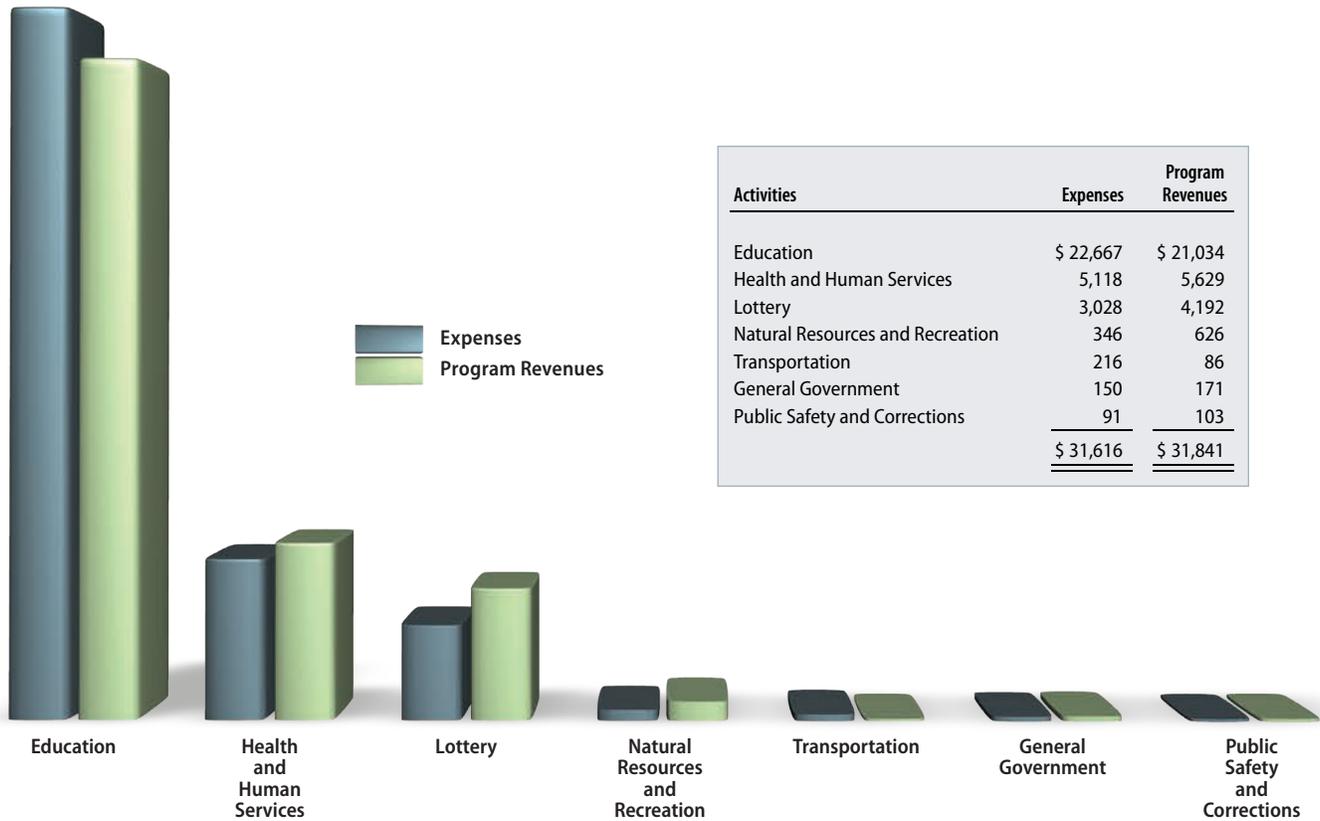


Total = \$97.7 Billion

* Totals may not add due to rounding

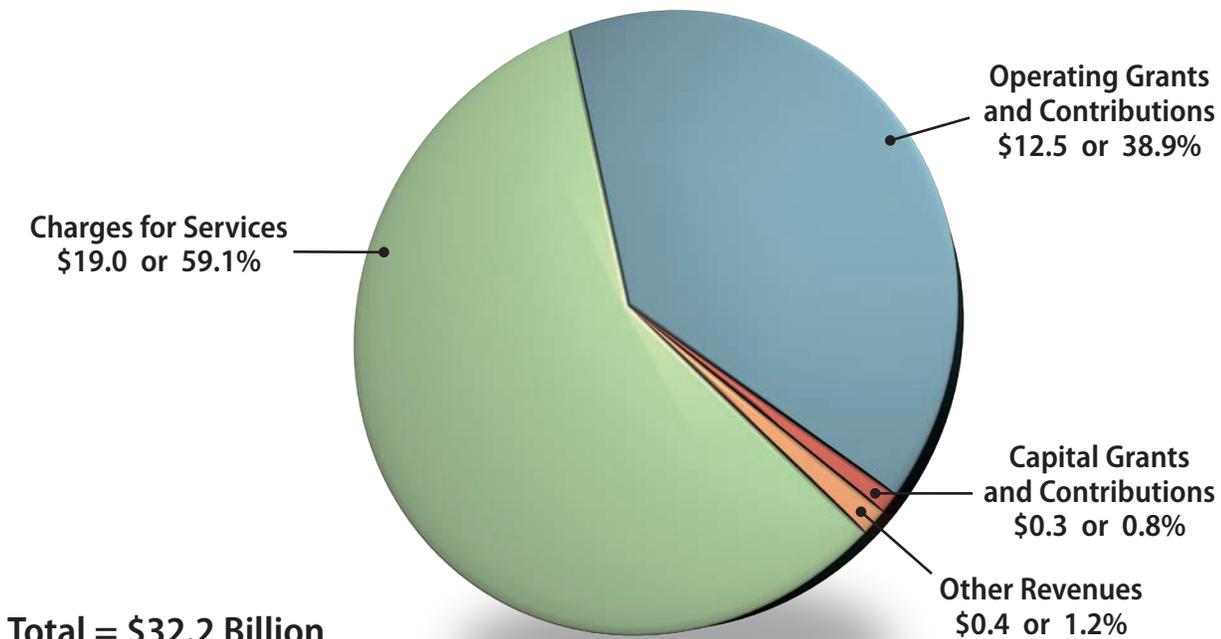
Expenses and Program Revenues: Business-Type Activities

For the Fiscal Year Ended August 31, 2012 (In Millions)



Revenue by Source: Business-Type Activities

For the Fiscal Year Ended August 31, 2012 (In Billions)*



* Totals may not add due to rounding

Governmental Activities

Governmental activities program revenue was \$50.2 billion, including charges for services of \$7.4 billion, operating grants and contributions of \$42.8 billion and capital grants and contributions of \$47.6 million. The largest change, a \$4.4 billion decrease, was for operating grants and contributions, which includes revenues from federal funds and interest and investment income. However, taxes had increases of \$4.7 billion from general revenue sources, with the largest increase in sales tax revenue.

Net Cost (Income) of the State's Governmental Activities

For the Fiscal Year Ended August 31, 2012 (Amounts in Thousands)

	Total Cost of Services	Net Cost (Income) of Services
General Government	\$ 3,116,737	\$ 1,058,097
Education	25,724,127	17,347,912
Employee Benefits	423,492	423,358
Teacher Retirement State Contributions	2,390,178	2,390,178
Health and Human Services	44,737,457	13,436,627
Public Safety and Corrections	5,294,730	4,408,721
Transportation	4,484,662	(666,821)
Natural Resources and Recreation	1,634,659	(125,210)
Regulatory Services	410,724	(304,993)
Interest on General Long-Term Debt	715,148	715,148
Total	<u>\$88,931,914</u>	<u>\$38,683,017</u>

Net Cost (Income) of the State's Business-Type Activities

For the Fiscal Year Ended August 31, 2012 (Amounts in Thousands)

	Total Cost of Services	Net Cost (Income) of Services
General Government	\$ 149,663	\$ (21,489)
Education	22,667,292	1,633,397
Health and Human Services	5,117,829	(511,380)
Public Safety and Corrections	91,313	(11,280)
Transportation	215,845	130,011
Natural Resources and Recreation	346,150	(279,547)
Lottery	3,027,943	(1,163,651)
Total	<u>\$31,616,035</u>	<u>\$ (223,939)</u>

Governmental activities expenses were \$88.9 billion. All functions of governmental activities in the government-wide statement of activities have a net cost, except the transportation, natural resources and recreation, and regulatory services functions, which report slight surpluses. The education function and the health and human services function account for 79.2 percent of governmental activities expenses and 79.6 percent of the net cost. The tax collections of the state provide the primary source of funding, which when added to program revenues, support payment for governmental services.

Business-Type Activities

Business-type activities generated program revenue of \$31.8 billion, including charges for services of \$19 billion, operating grants and contributions of \$12.5 billion and capital grants and contributions of \$259.8 million. The total expenses for business-type activities were \$31.6 billion. The largest changes occurred in education, with a \$440.8 million increase for colleges and universities, and in the health and human services function, where there was a decrease of \$938.1 million in unemployment benefit payments as the unemployment rate dropped to 7.3 percent. There was a total gain from the government's business-type activities of \$4.7 billion in comparison to the prior year's gain of \$4.8 billion.

Financial Analysis of the State's Funds

Governmental Funds

As of Aug. 31, 2012, governmental funds reported fund balances of \$44.2 billion. The general fund reported a positive \$8.9 billion fund balance.

General Fund

The fund balance for the general fund as of Aug. 31, 2012, was \$8.9 billion, an increase of \$1.7 billion from fiscal 2011, mostly due to an increase in tax rev-

enues. The Texas Constitution, state statute, and federal rule or bond covenants constrains \$7.1 billion. The unassigned fund balance was \$1.1 billion. Contributing to the higher balance were decreases of \$2.4 billion in spending for education and decreases of \$6.5 billion in federal revenues. Decreases in supplemental nutrition assistance programs (SNAP), child nutrition programs and Medicare programs accounted for \$2.8 billion of the federal revenue decrease.

State Highway Fund

The fund balance for the state highway fund as of Aug. 31, 2012, was \$852.9 million, an increase of \$101.4 million from \$751.5 million as of Aug. 31, 2011. Cash and cash equivalents decreased \$514.7 million as highway reconstruction and maintenance costs increased by \$154.6 million.

Permanent School Fund

The fund balance for the permanent school fund (PSF) as of Aug. 31, 2012, totaled \$28.8 billion, an increase of \$1.9 billion since Aug. 31, 2011. This increase was primarily attributable to an increase in valuation of investments of \$1.7 billion. Value in the fund provided \$1 billion in transfers to provide funding for public education. The PSF also supports the state's public school system through a bond guarantee program, where the PSF is pledged to guarantee bonds issued by Texas school districts, enhancing their credit rating. As of Aug. 31, 2012, a total of \$53.6 billion in school district bond issues were guaranteed.

Proprietary Funds

Proprietary funds reported a net position of \$46.8 billion as of Aug. 31, 2012, an increase of \$4.7 billion from fiscal 2011. The state's public colleges and universities hold 91.1 percent of the reported net position in proprietary funds.

Colleges and Universities

Colleges and universities' net position as of Aug. 31, 2012, totaled \$42.6 billion, an increase of \$3.5 billion from Aug. 31, 2011. There were increases of \$637.4 million and \$470.9 million for both operating revenues and operating expenses, respectively, with an overall increase of \$166.4 million in operating income. There was \$4.5 billion in nonoperating investment and interest income in fiscal 2012, accounting for most of the \$4.8 billion in total nonoperating revenues over expenses. Stable market conditions produced positive investment returns. The permanent university fund increased net position by \$782.4 million. Mineral income from the fund's land possessions increased to \$954.5 million. This endowment fund contributes to the support of 24 institutions in the University of Texas System and the Texas A&M University System.

Unemployment Trust Fund

The unemployment trust fund reports activity related to the administration of statewide unemployment benefits in proprietary funds. The funds reported a net position of \$29.3 million as of Aug. 31, 2012, an increase of \$842.2 million from \$(812.9) million as of Aug. 31, 2011. During fiscal 2012, unemployment taxes collected increased \$218.7 million from \$2.7 billion in 2011 while federal revenues decreased \$734.6 million from \$3.5 billion in 2011. Benefit payments decreased \$949.9 million as the unemployment rate dropped to 7.3 percent from 8.2 percent in 2011.

Lottery Fund

The Texas Lottery Commission operates on-line and instant ticket lottery games to generate revenue for the state's foundation school fund. The lottery fund had a net position of \$149.1 million as of Aug. 31, 2012, compared to \$118 million at the end of fiscal 2011. Lottery sales for the year ended Aug. 31, 2012, totaled \$4.2 billion, an increase of \$379.6 million from fiscal

2011. Distributions to state agencies totaled \$1.1 billion for fiscal 2012 compared to \$970.5 million for 2011, an increase of 13.8 percent.

The lottery fund's short-term and long-term investments approximated \$1.1 billion. The lottery fund's liabilities include amounts owed to the state's foundation school fund for August accrued sales for fiscal 2012, and for investment purchases, vendor payables and prize payment obligations.

Fiduciary Funds

Fiduciary funds reported \$151.6 billion in net position as of Aug. 31, 2012, an increase of \$4.2 billion from \$147.4 billion in fiscal 2011, a 2.9 percent increase.

Pension and Other Employee Benefit Trust Funds

Total net position for pension and other employee benefit trust funds was \$135.1 billion, an increase of \$4.5 billion from the \$130.6 billion reported in fiscal 2011. The majority of plan assets are held as investments for the pension funds. Additions from all sources decreased \$8.1 billion from fiscal 2011, while benefit payments increased \$870.2 million. Decreases in additions are due primarily to less favorable conditions in the financial markets and legislative decreases to state contributions. The return for investments for the state's two largest pension systems, the Teacher Retirement System of Texas and the Employees Retirement System of Texas, was 7.6 percent and 8.2 percent, respectively, compared to the previous year's returns of 15.5 and 12.6 percent, respectively.

External Investment Trust Fund

The Treasury Safekeeping Trust Company (Trust Company) is the only external investment trust fund. It administers and invests funds belonging to state and local entities as well as provides direct access to services of the Federal Reserve System. The Trust reported a

total net position of \$13.5 billion as of Aug. 31, 2012, a decrease of \$421.2 million from fiscal 2011. The decrease in net position is due to withdrawals by local government entities, leaving a lower base from which to invest.

Private-Purpose Trust Funds

Total net position for private-purpose trust funds was \$2.9 billion as of Aug. 31, 2012, an increase of \$82.2 million from fiscal 2011. Additions from all sources of \$525.9 million exceeded total deductions of \$443.6 million.

Budgetary Highlights

Variances for the General Fund

The differences from original and final revenue budgets are due to both economic and legislative reasons.

Budget mechanisms allow budget revisions for certain revenues when collections exceed the original budget. Accordingly, major revisions were made to both total revenues and expenditures for a net change of \$2.7 billion.

There was a positive \$139.8 million variance between the actual to final budget revenues. The most positive revenue variance occurred for tax revenues, which reported a \$2.8 billion difference with actual exceeding final budget. The positive tax revenues variance was offset by a negative revenue variance occurring with federal revenues and sales of goods and services, where actual was below final budget.

The largest negative expenditure variances related to the education function and the health and human services function.

Capital Assets – Net of Depreciation and Amortization

August 31, 2012 and 2011 (Amounts In Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2012	2011	2012	2011	2012	2011
Land and Land Improvements	\$ 9,519,723	\$ 8,915,039	\$ 1,570,622	\$ 1,524,203	\$ 11,090,345	\$ 10,439,242
Infrastructure	59,314,678	58,354,931	2,539,629	2,416,197	61,854,307	60,771,128
Construction in Progress	6,178,225	5,033,330	2,128,658	2,635,344	8,306,883	7,668,674
Buildings and Building Improvements	2,380,577	2,327,370	14,296,422	12,939,434	16,676,999	15,266,804
Facilities and Other Improvements	70,273	70,075	892,674	822,863	962,947	892,938
Furniture and Equipment	251,025	242,873	1,509,776	1,435,699	1,760,801	1,678,572
Vehicles, Boats and Aircraft	429,389	418,239	75,279	65,513	504,668	483,752
Other Capital Assets	172,644	174,310	931,091	941,698	1,103,735	1,116,008
Intangible Capital Assets, Net	132,248	131,327	399,315	408,891	531,563	540,218
Total Capital Assets	<u>\$ 78,448,782</u>	<u>\$ 75,667,494</u>	<u>\$ 24,343,466</u>	<u>\$ 23,189,842</u>	<u>\$ 102,792,248</u>	<u>\$ 98,857,336</u>

Capital Assets and Debt Administration

Capital Assets

As of Aug. 31, 2012, the state had \$102.8 billion in net capital assets. This total represents a net increase of \$3.9 billion in total capital assets or 4 percent from fiscal 2011. Included in this amount are additions to the state's highway system of \$1.1 billion by the Texas Department of Transportation (TxDOT). Institutions of higher education also added \$1.3 billion to buildings and building improvements.

To ensure future availability of essential services and to finance highway capital improvements, TxDOT made commitments for construction contracts, comprehensive development agreements and pass-through toll agreements totaling an estimated \$14.4 billion. These commitments extend beyond the end of the fiscal year and represent future costs to the state. This amount is not recognized as a liability because the terms of the contracts or agreements were not met and benefits were not received as of the end of fiscal 2012.

Note 2 provides detail about the state's capital assets and Note 15 details the state's significant commitments related to future capital expenditures.

Infrastructure Assets

The value of the state's infrastructure assets is included in the governmental activities column of the government-wide statement of net position.

The state accounts for its system of roads and highways using the modified approach. TxDOT developed a system of management, the Texas Maintenance Assessment Program (TxMAP), designed to maintain the service delivery potential of the state's roads and highways to near perpetuity.

The state's policy is to maintain its interstate highways at a condition level of 80 percent, its non-interstate highways (farm-to-market and other road systems) at a condition level of 75 percent and its Central Texas Turnpike System at a condition level of 80 percent. The condition assessment results for fiscal 2012 reflect condition levels of 82 percent (83 percent in fiscal 2011) for the interstate system, 77.7 percent (78.5 percent for fiscal 2011) for the non-interstate system and 86.2 percent (89.9 percent for fiscal 2011) for the Central Texas Turnpike System.

In fiscal 2012, the estimated maintenance expenditures required to maintain the highway system at or above the adopted condition levels for interstate highways were \$191.4 million, \$2.2 billion for the non-interstate system and \$10 million for the Central Texas

Turnpike System. Actual expenditures were \$346.3 million for the interstate system, \$1.6 billion for the non-interstate system and \$10.6 million for the Central Texas Turnpike System. Additional information on the state's road and highway infrastructure is presented in the financial section's required supplementary information other than MD&A.

Debt Administration

The state of Texas issues both general obligation bonds and revenue bonds. Each series of revenue bonds is backed by the pledged revenue source and restricted funds specified in the bond resolution. Most revenue bonds are designed to be self-supporting from a primary revenue source related to the program financed.

The state's general obligation bond issues were rated Aaa by Moody's Investors Service, AA+ by Standard & Poor's and AAA by Fitch Ratings as of August 2012. During fiscal 2012, Texas state agencies and institutions of higher education issued \$2.2 billion in state bonds to finance new construction, transportation, housing, water conservation and treatment, and other projects. General obligation debt accounted for \$603 million of state bonds issued in fiscal 2012. This debt, which can only be authorized by a constitutional amendment, carries the full faith and credit of the state. The remaining \$1.6 billion is due to new issuances of revenue bonds, which are serviced by the revenue flows of individual entity projects. Bonds retired during the year were composed of \$448.1 million in general obligation bonds and \$808.3 million in revenue bonds. Also, \$86.7 million in general obligation bonds and \$702.8 million in revenue bonds were refunded. The total outstanding general obligation debt of the state after new issuances, retirements and refundings as of Aug. 31, 2012, was \$14.5 billion. This represents an increase of \$68.7 million or 0.5 percent from fiscal 2011. An additional \$18 billion of general obligation bonds were authorized but are unissued. Total revenue bonds outstanding

as of Aug. 31, 2012, were \$23.3 billion, which is a decrease of \$912.1 million or 3.8 percent from fiscal 2011. The net decrease of \$912.1 million for revenue bonds is mostly due to a restatement of conduit debt by TxDOT. Note 5 discloses the details on the state's long-term liabilities and Note 6 provides detailed information on the state's bonded indebtedness.

Economic Condition

Texas' economic growth, as evidenced by employment and gross domestic product, matched its long-term average rates in 2012. During the period from December 2011 to December 2012, Texas' nonfarm employment increased by 260,800 jobs, a 2.5 percent year-to-year growth rate. The unemployment rate dropped markedly in recent months, from 7.4 percent in December 2011 to 6.1 percent in December 2012, outperforming the nation's improvement from 8.5 percent to 7.8 percent.

Texas' real gross state product (GSP) increased by 3.2 percent in 2012, more than a percent faster than the nation's 2.1 percent. New oil and gas drilling technologies, a relatively healthier housing market, and robust export performance coalesced to continue a pattern of growth. On the downside, this rate of economic expansion was slower than that of 2010 and 2011, as the oil and gas exploration stabilized after three years of solid growth. Consumer confidence in the West South Central states still reached its highest level since 2008, as consumers reported less anxiety about the stability of national and global economies.

All but one of the state's 11 major industries added jobs in 2012. After four years of net job losses, the fastest job growth rate was in the construction industry, at 6.6 percent, although trade, transportation, and utilities added the largest number of jobs (56,000). Three other service-providing industries added more than 45,000 jobs and experienced growth rates exceeding 3 percent for the year, with these being professional and business

Outstanding Bonded Debt

August 31, 2012 and 2011 (Amounts in Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2012	2011	2012	2011	2012	2011
General Obligation Bonds Payable	\$ 11,314,325	\$ 11,519,544	\$ 3,229,549	\$ 2,955,651	\$ 14,543,874	\$ 14,475,195
Revenue Bonds Payable	4,276,898	5,455,607	19,033,469	18,766,862	23,310,367	24,222,469
Total Bonds Payable	<u>\$ 15,591,223</u>	<u>\$ 16,975,151</u>	<u>\$ 22,263,018</u>	<u>\$ 21,722,513</u>	<u>\$ 37,854,241</u>	<u>\$ 38,697,664</u>

services, education and health services, and leisure and hospitality services. Information, which includes the broadcast media, telecommunications and internet-based services, was the only major industry to lose jobs, sacrificing 1.7 percent of its workforce or 3,300 jobs.

The state's export sales reached another record high during the year and now account for 19.3 percent of the state's gross domestic product. Texas continues to lead all other states in the value of its export trade, which totaled \$266 billion in 2012.

Texas' recovery will continue to outpace that of the nation for the same reasons as in the past. These include continued net migration to the state, an export-conducive location in one of the nation's healthiest economic

regions, an experienced workforce, comparatively strong real estate markets and relatively low costs for business operations.

Contacting the State's Financial Management

This financial report is designed to provide the state's citizens, taxpayers, customers, investors and creditors with a general overview of the state's finances and to demonstrate the state's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Financial Reporting section of the Texas Comptroller of Public Accounts at 111 E. 17th Street, Austin, Texas 78774.

