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Fitch: TX Supreme Court Decision Could Benefit School Districts.

Fitch Ratings-Austin-03 September 2014: If the state Supreme Court upholds a lower court ruling on the constitutionality of the state's K-12 school funding program, the state legislature will likely be forced to increase state funding for school budgets, revise the funding system to equalize the benefits, and change the local property tax structure and address its limitations, Fitch Ratings says. In general, we believe such changes would benefit districts in the state, though the benefits will vary and a revised equalization approach may produce both winners and losers. If the state Supreme Court overrules the judge's ruling, many districts will continue to operate with less state funding as a result of the 2012-13 biennium cuts. Late last week a state district court found that the current funding technique violates the state constitution.

The districts' cost-cutting efforts began in 2012, and for some time we have cited the lack of local tax-rate flexibility as a programmatic credit concern. These pressures have been exacerbated due to rapid enrollment growth in fast-growth districts, as the state's economy continues its strong post-recession recovery.

School funding has been one of many perennial growth-related challenges faced by the state in recent decades, with past court decisions requiring state legislative action to adjust education funding. Although the timing of a final Supreme Court decision is unknown, the state continues to benefit from significant fiscal flexibility, including from its large reserve balances.

The district court judge found that the finance system prevents the delivery of an adequate education to all students in the state and does not provide enough money for a "general diffusion of knowledge." The judge also found the system essentially creates a statewide property tax over which districts have little discretion, while inefficiently distributing education dollars. The ruling was the product of the consolidation of six lawsuits representing 75% of Texas school children. The judge for the case agreed to re-open testimony in January 2014 after the Texas Legislature restored \$4.5 billion in school funding in its 2013 session. The increased funding levels apply to school district budgets in fiscal 2014 and 2015.

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