# Fitch: Of Texas Constitutional Amendments, Only K-12 Funding May Pressure Budget

Fitch Ratings-New York-07 December 2023: Most of the 13 of 14 constitutional amendments approved by Texas voters during the November 2023 election will have limited credit implications for the state or municipalities, Fitch Ratings says. The majority of amendments fund one-time spending initiatives, drawing from the state's accumulated balances or relatively minor diversions of future funding from its robust rainy-day fund (the Economic Stabilization Fund, ESF). One potential exception is Proposition 4, which will reduce local property taxes for schools and shift some funding responsibility to the state. This may pressure the state's future budgets and leave school districts more exposed to state fiscal actions during downturns.

Proposition 4 implements legislation passed in special session that added more than $13.3 billion of tax relief to the $5.3 billion already in the fiscal 2023-2025 biennium. The tax reduction will be provided by reducing (compressing) local property tax rates for school districts, increasing the state-mandated school homestead exemption, prohibiting school districts from raising homestead exemptions, and capping appraisal increases for properties not subject to homestead exemptions. Districts' operating levy will be compressed by 10.7 cents per $100 assessed valuation, an 11% decrease from the maximum maintenance and operations tax rate of 96.5 cents in fiscal 2024.

The state will be responsible for a greater portion of school district funding to compensate for lower local taxes. The legislation and Proposition 4 provide a bypass of the state's constitutional spending limit to pay for the property tax relief by drawing down its substantial accumulated carry-over balance. Although state officials expect to be able to absorb the obligation, estimated by the state Comptroller's office at just over $6 billion per year, within normal revenue growth, there is some risk to the state in funding a significant new ongoing expense with accumulated balances that by definition are one-time in nature.

Proposition 4 did not increase resources available to school districts, which have not received an increase in the basic allocation since at least 2019, nor did it provide for salary increases for teachers. These issues are expected to be addressed in separate legislation, which has not emerged from committee due to unrelated disagreements over the use of vouchers. The inability to move the legislation forward highlights the vulnerability of school districts to state spending cuts in the event of a future downturn in state revenue.

Proposition 9 will provide a $3.3 billion lump-sum contribution to the Teachers Retirement System that will fund a one-time supplemental payment and a cost-of-living adjustment (COLA). Over the longer term, if the plan's return assumptions are not met, the COLA can contribute to an increase in the state's net pension liabilities.

Proposition 5 tapped the accumulated surplus for a one-time allotment of $3 billion to create the Texas University Fund (TUF), which will be available to certain qualifying state universities to enhance research capabilities. Proposition 5 also authorized the annual transfer of up to $100 million from ESF earnings to the TUF in years with positive ESF earnings, a relatively modest amount given the roughly $20 billion ESF balance. While not a significant relative to the ESF balance, the transfer to the TUF is emblematic of the state's tendency to tap the ESF for non-fiscal policy priorities.

Several amendments provided voter approval for spending programs authorized in the enacted budget. These draw down the accumulated balance but do not create ongoing funding commitments from general revenues. These include $1 billion to a newly created Texas Water Fund (Prop 6); $10 billion to a newly created Texas Energy Fund (Prop 7); $1.5 billion to fund broadband expansion (Prop 8); and $1 billion to acquire and develop state parks (Prop 14).

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