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# DEMOGRAPHICS, COMPETITION TEST SCHOOL BUDGETS



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## Key Takeaways

- Demographic shifts, more competition in the public school arena, and state aid formulas are driving challenges.
- If credit deterioration persists, some states may opt to reform their education funding models.
- Credit selection within the school district sector is becoming increasingly important.



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Throughout 2024, public K-12 school districts in certain areas of the country reported growing budget imbalances on account of slowing revenue, waning federal aid, and rising costs. Breckinridge anticipated weaker post-pandemic school district fundamentals in 2022 (*Is it time to go back to school on school credit?*). Some struggling districts are now being forced to make significant budget cuts, and in December, *Moody's* placed the K-12 sector on “negative outlook.”<sup>1</sup>

The school district budgetary challenges highlight demographic shifts driving enrollment changes. These include aging population, outmigration from high-cost regions, and lower fertility rates. Budget challenges also highlight the impact of school choice and the limitations of current school finance formulas. School district formula grants sometimes limit state disbursements or place limits on locally derived revenue. We anticipate that more pressure may be placed on states in 2025 to support modern enrollment realities. This might include three states with a significant municipal market presence: Washington,<sup>2</sup> California,<sup>3</sup> and Florida.<sup>4</sup>

### DEMOGRAPHIC SHIFTS HAVE MORE PERMANENTLY CHANGED ENROLLMENT PATTERNS

Following the end of significant federal pandemic aid, weakening credit fundamentals have refocused school district investors' attention on negative enrollment patterns. Aging population, mobility and migration due to cost-of-living concerns, and lower fertility rates are root causes of disenrollment patterns. Fertility, in particular, declined in every U.S. state between 2005 and 2022, and it is likely to continue, especially in the Northeast and the West, which have the Nation's lowest birth rates.<sup>5</sup>

### SCHOOL CHOICE CONTINUES TO GROW, INCREASING COMPETITION FOR THE PUBLIC SCHOOL SECTOR

School choice is also a driver of disenrollment trends. Competition from charter and private schools can draw students away from their public district. As of 2024, well over half of U.S. states had some kind of school choice program.<sup>6</sup> School choice programs continue to expand, making it easier for school-age children to attend public charter schools or magnet schools, private schools, or receive their learning online or via homeschooling models.<sup>7</sup> Proponents of school choice cite the benefits of allowing students to obtain preferred schooling, and the benefit of decoupling school quality from location of residence. As more states pass laws allowing or expanding school choice, traditional public school districts may be negatively impacted via loss of students, loss of teachers, and/or lack of public support.

### CURRENT STATE FUNDING FORMULAS CAN BE RESTRICTIVE & CALLS FOR REFORM ARE GROWING

State aid can both ameliorate and exacerbate the budgetary challenges vexing school districts. State funding formulas tailored to current enrollment realities could help reduce credit weakening. Nationwide, state support comprises nearly half of revenue for public schools. In over 40 percent of U.S. states, state funding provides at least 50 percent of districts' revenue.<sup>8</sup>

1. “*Moody's issues negative outlook for K-12 public schools in 2025*,” Yahoo! Finance, December 12, 2024. Note that S&P has not yet published its state and local government outlook for 2025, and Fitch remains neutral on states and local governments (which include school districts).

2. “*Schools across WA are struggling to balance their budgets*,” The Seattle Times, May 27, 2024.

3. “*Fiscal cliff' approaching for some districts in California as costs soar and enrollment falls*,” EdSource, June 21, 2023.

4. “*Florida's top education official says public school closures a tradeoff for school choice*,” Politico, May 29, 2024.

5. “*Fertility Rates by State*,” National Center for Health Statistics, December 15, 2024.

6. “*School Choice In America*,” EdChoice, December 15, 2024.

7. IBID.

8. State enhancement and intercept programs also provide state backing in the event of default that help school district bonds maintain higher liquidity and help lower-rated districts maintain investor appeal. Over 30 states around the US provide some form of enhancement.



Despite their importance, most states use funding formula models designed in times of growing or stable enrollment. Thirty-five states and Washington, DC, use a primary funding model for school districts that is based on student counts.<sup>9</sup> Per-pupil funding models impact districts with declining pupil counts and can sometimes limit a district's ability to raise revenue by other means, such as effective caps on property tax revenue.<sup>10</sup> While state spending on public education increased in all but five U.S. states in 2024,<sup>11</sup> calls for changes to funding models have been growing in certain regions. It is possible for states to alter their funding formulas to allow for greater flexibility in revenue generation.

Breckinridge continues to see value in independent research for the public K-12 school district sector. Default risk in the K-12 public school space remains extremely low given strong state oversight and credit enhancement programs for districts in many U.S. states. However, ratings risk is salient given the potential for more rating agency downgrades. The fiscal issues challenging certain districts are not necessarily limited to lower-rated, smaller, or poorer issuers. Focusing research efforts based on rating, enrollment size, or tax base is not entirely possible. We do not expect to materially lighten our K-12 sector exposure, but we may become increasingly selective with school district credits. Where credit distress is materializing, we are on the lookout for the possibility of state intervention or state funding changes.

9. "[50-State Comparison: K-12 Funding](#)," Education Commission of the States, December 15, 2024.

10. Washington is a great example of this. Levy lids following a 2012 state supreme court decision that increased per pupil funding has hurt wealthy districts experiencing enrollment declines in recent years.

11. "[2024 State Expenditure Report, Fiscal Years 2022 – 2024](#)," National Association of State Business Officers," 2024.

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