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No Department of Education? What It Means for Municipal Bonds.

Eliminating the DOE will have little impact on municipal bonds, as schools rely mostly on state and local funding, though short-term disruptions in grants and student loans are possible.

We believe the elimination of the federal Department of Education (DOE) will have a muted impact on the municipal market.

Public school districts, charter schools, private schools, colleges, universities, and community colleges borrow money in the municipal market. The bonds pay for facility improvements and are repaid through revenues – almost none of which originate from the federal government. If the federal Department of Education is eliminated, the closure will not impact these borrowers' long-term credit quality.

Elementary and secondary (K-12) education funding is the responsibility of states, and on average, state funds account for about half of a school's budget. An additional 40% of school budgets are funded by local governments, usually from property taxes. The typical K-12 school in the United States receives less than 10% of its funding from the federal government1. And much of that 10% isn't from the Department of Education. The USDA, for example, administers the National School Lunch Program, which provides free to reduced meals for students living near the poverty level. Head Start is funded through the Department of Health and Human Services.

The Department of Education does administer grants for K-12 schools, most notably through the Title I and IDEA programs. A school qualifies for Title I funding if a large percentage of students come from low-income homes. IDEA (Individuals with Disabilities Education Act) funds and related programs provide money for special education funding. Each program has a total budget of $18 billion and $15 billion, respectively, in 20232. There are other grant programs as well, but these are the two largest. In all, about $80 billion in grants were awarded in 2023 by the Department of Education to K-12 programs.

The elimination of the Department of Education doesn't eliminate funding for these programs, which would be a blow to the most vulnerable populations. We already see that funding for the public school system can come from multiple federal agencies. These programs can also be administered through other state agencies, like the Department of the Treasury.

The Department of Treasury would likely also take over the Department of Education's largest responsibility as well: the federal student loan program. The transition of the K-12 grant and loan programs to other agencies poses near-term credit concerns as the likelihood of funding delays, slower processing times, and errors are more likely as new teams get up to speed. For K-12 schools, delays are unlikely to result in bond defaults due to the small amount of the total budget these funds make up. Most school district debt is paid directly from property taxes as well.

Changes to the federal student loan program, Pell Grants, and federal student aid could significantly impact colleges and universities – whether the programs are administered in the Department of Education or the Department of Treasury. Delays will require colleges to rely upon their own liquidity, but the confusion from the transfer to another department will not have a long-term impact and should resolve in the near term. However, changes to the programs themselves could significantly impact institutions of higher education.

The student loan program ensures inexpensive funds are available for students to borrow to attend almost any higher education institution in the country. Beyond more expensive borrowing, a greater reliance on the private loan market means more discerning lenders with fewer dollars to lend. We do not know what changes, if any, will be considered, but we will continue to watch as events unfold.

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