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S&P Bulletin: Michigan's 2020 Budget Agreement Is Not Expected To Materially Affect Most Schools, Despite Aid Cuts

NEW YORK (S&P Global Ratings) July 8, 2020–On June 29, Michigan's governor and legislature reached an agreement to balance the state's 2020 budget for the fiscal year ending Sept. 30. We believe this agreement, which includes a $256 million reduction in per-pupil state aid, does not pose immediate fiscal pressure for most public schools, including locally governed school districts as well as charter schools. This is primarily because the state will be allocating $530 million in federal CARES (Coronavirus Aid, Relief, and Economic Security) Act funding for COVID-19 related expenses that schools have or will incur as they prepare for the 2020-2021 academic year. Our understanding is that this funding will function as a grant to schools to offset related expenses. And while the exact timing and allocation of funds is still uncertain, it affords flexibility as the federal funding can provide relief for COVID-related expenses that may have otherwise been supported by state aid.

The $256 million state aid reduction translates to a $175 per-pupil, or 23%, cut in the August 2020 disbursement to schools, which equates to a 2% cut to the total fiscal 2020 foundation allowance. The August payment is the last payment of the state's fiscal year, as funding is distributed to schools from October through August in equal increments. S&P Global Ratings maintains public ratings on 317 school districts and 28 charter schools in Michigan, with median enrollment of 1,985 and 811, equating to a median cut of $347,000 and $142,000, respectively. The state has not released new information regarding fiscal 2021 funding since its May revenue estimating conference, at which time it projected a $3 billion budget shortfall, with more than two-thirds of its funding derived from sales and income taxes. We expect more clarity in the coming months as budget deliberations continue for the fiscal year beginning Oct. 1. In our view, as state aid is a major revenue source for charter schools and most school districts, Michigan schools will face increased credit pressure should state aid cuts increase in magnitude in fiscal 2021, especially if they are not offset by additional relief funding. This stress would be heightened for those schools with a greater reliance on state funding, low liquidity, or already limited operations, such as many of our rated Michigan charter schools which have a weaker ratings distribution compared to the sector as a whole. For more information on Michigan charter schools, see our "Charter School Brief: Michigan," published May 17, 2019, on RatingsDirect.

In anticipation of possible cuts, school districts and charter schools across the state have already begun adjusting their budgets, focusing on staffing plans and expense flexibility. In our view, these decisions will be key to maintaining credit quality. Those that have already taken action will be better prepared for the August reduction and possible further cuts. Many schools annually issue state aid anticipation notes in July and August (and in particular through the Michigan Finance Authority borrowing pool), which should help weather potential cash flow disruptions. We expect the number of borrowers and sizing of borrowings could increase, in anticipation of further cuts. While the pandemic has resulted in certain expense savings from facilities being closed and federal relief provides near-term support, we expect increased costs associated with preparing to reopen in the fall will place a greater burden on schools' fiscal 2021 expenses. In addition, we believe enrollment trends could also fluctuate for individual schools given uncertainty around modes of instruction, which would have a direct impact on revenues and operations. We expect to monitor state aid updates closely in the coming months and evaluate each school's operating flexibility, liquidity cushion, and ability to make necessary expense adjustments in response to any further funding cuts.

This report does not constitute a rating action.