Stoever Glass & Co
30 Wall Street, New York, NY10005

School District Debt: a Safe Bet

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Dick Larkin
Director of Credit Analysis
Stoever Glass & Co., Inc.
P: (862) 432-8818
E: dlarkin@stoeverglass.com

In most of the country, primary and secondary education is provided by independently elected boards that have their own taxing power, separate from the cities they serve. In those situations, fiscal distress or bankruptcy of a city does not affect payments on school district debt.

Also in the equation, school districts receive substantial aid from its state; I've seen situations where as much as 70% of a district's budget comes in the form of state aid. And although distress at the state budget level might result in a downgrade of the state's rating, that doesn't automatically reduce funding to schools. There have been a number of lawsuits that rule access to education must be fair and equal throughout the state. That's why education funding is usually the last item that a state will reduce to balance its budget.

And because the state's funding represents a large investment, states will usually intervene and impose a takeover if a school district becomes distressed or insolvent. That has been the case for the large school districts in Philadelphia and Chicago over the years.

Finally, many states have laws that provide an extra layer of protection for bondholders. It comes in the form of a requirement to withhold and redirect state aid to the bond paying agent if a school district fails to make its debt payment on time. That is the case in Pennsylvania and New York, and the law has been successfully used several times in Pennsylvania to make timely debt payments by some distressed districts. It is for those reasons that defaults by school districts are lower than just about any other class of debt other than state general obligation debt.

About the Author

RICHARD P. LARKIN, Stoever Glass & Co., Inc.

Richard Larkin, a recognized 40 year industry veteran, has joined SG & Co. as Director of Municipal Credit Analysis. Mr. Larkin began his career in credit rating analysis at Standard & Poor's in 1975. After rising through the ranks in various analytical and management positions, Dick left S&P as its Chief Municipal Rating Officer, responsible for municipal rating policy, practices, governance and criteria. In 1998, Mr. Larkin joined Fitch Ratings as Chairman of its Public Finance Criteria Committee.

"Dick will be a unique resource to Stoever Glass' municipal clients. His knowledge in specific issues and areas of the municipal bond industry will aid our representatives and their clients in making educated decisions, in a sector where this type of research is unique," said Roland Stoever of Stoever Glass.