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Public K-12 School Districts – US

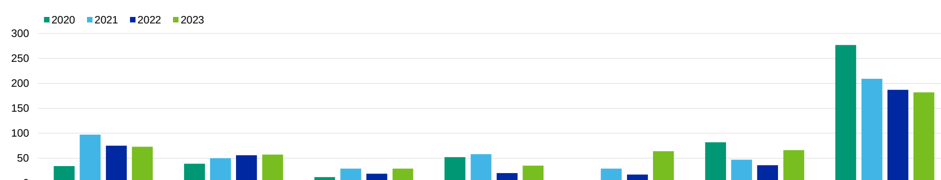
State initiatives complicate budget management, increase competition

State legislation surrounding K-12 school instruction and health and safety continue to proliferate, raising costs for districts. Simultaneously, growing initiatives focused on providing school choice is turning K-12 education into a competitive endeavor. These emerging regulatory trends will create governance challenges in the sector.

State requirements add to budget management challenges

A growing number of initiatives by state legislatures, particularly in health and safety (see Exhibit 1), has increased the cost and administrative burden for the provision of K-12 instruction. Legislation that targets how and what students are taught has proliferated, while a focus on accountability and tracking student outcomes through data has emerged as well. Additionally, following the coronavirus pandemic and high-profile episodes of violence, states have become more focused on student health and safety. Taken together, these state-mandated requirements are complicating school district budget management, one of our key governance considerations under our ESG framework.

Exhibit 1
Legislative volume exemplifies areas of focus for state governments
Select type of K-12 legislation enacted by states by year



	Curriculum	Teaching - certification and licensure	Teaching - professional development	Accountability	Data systems	School safety	Health
2020	34	39	12	52	0	82	277
2021	97	50	29	58	29	47	209
2022	75	56	19	20	17	36	187
2023	73	57	29	35	64	66	182

No legislation related to data systems was reported in 2020.
Sources: Education Commission of the States and Moody's Ratings

Districts will have to contend with these additional requirements by increasing their budgeted expenditures, which are already on a sharply upward trend. Notably, per-pupil spending reached a historically high $16,340 (nationwide) per pupil[1] in 2022 – an 8% year-over-year increase. While wages have grown, additional requirements have also driven costs higher.

Health requirements, in particular, add costs for school districts. For example, districts in Alabama are facing requirements to hire mental health staff[2]. In Kentucky, districts are being encouraged to keep medical supplies like bronchodilators (asthma inhalers) in two locations per school[3]. There are also continuing requirements to offer Covid-19 testing across the nation. With respect to safety, states are increasingly imposing requirements on districts for emergency response plans, training and additional school safety officers. School districts must also grapple with the additional challenge of finding qualified health and safety professionals.

In the area of curriculum and teaching, schools are being pushed to carry out additional teacher training while requiring additional student instruction in certain topics. Media literacy instruction, for example, has now been implemented in four states: Delaware (Aaa stable), New Jersey (A1 stable), Texas (Aaa stable) and California[4] (Aa2 negative). New instruction mandates require additional training and certification along with the purchase of new curriculum materials, all of which involves additional expenditure.

Lastly, legislation pertaining to accountability and school district data systems is proliferating. Many states, including Indiana (Aaa stable), are requiring data collection by and from districts in order to assess concerns such as school performance and learning loss. Looking ahead, legislative initiatives on chronic absenteeism will grow. So far this year, 60 pieces of legislation have been introduced in states[5] in an attempt to address truancy, which has grown markedly since the pandemic. Chronic student absences degrade student performance, which can challenge resource-constrained schools by increasing the need to provide remedial services. Moreover, since state aid is generally allocated based on average daily attendance, chronic absenteeism can have a revenue impact. If the legislative initiatives bear fruit and reduce absenteeism, some of these pressure could be alleviated.

Cybersecurity is also coming into focus. Iowa (Aaa stable), for example, now requires all school district vendors to meet certain requirements for data security. While third party vendor security is ultimately beneficial with respect to cyber risk mitigation, it will likely lead to higher vendor costs. And, as with all requirements, compliance is generally costly and diverts limited resources away from other needs.

While federal funding initiatives have been limited – the last major federal initiative was the Every Student Succeeds Act (ESSA) in 2015 – increased aid[6] is helping to offset some of these expenses. Federal coronavirus aid (Elementary and Secondary School Emergency Relief, or ESSER) also helped districts significantly without imposing any major conditions. That said, ESSER money must be spent by September 2024. This may leave school districts with additional costs and less money to cover them.

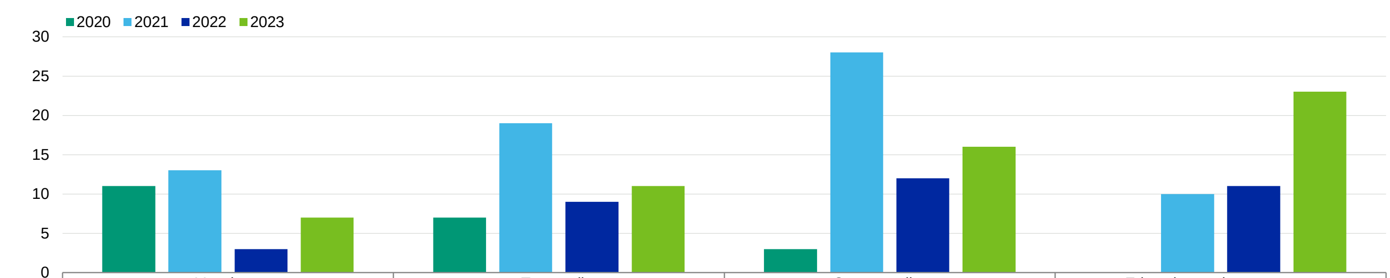
Growing school choice creates a competitive environment for school districts

While state-imposed requirements challenge school budgets, a growing chorus of parents and legislators focused on providing school choice (see Exhibit 2) is turning K-12 eduction into an increasingly competitive endeavor.

Exhibit 2

School choice is gaining traction nationwide

Select type of K-12 legislation enacted by states by year



	Vouchers	Tax credits	Open enrollment	Education savings accounts
2020	11	7	3	0
2021	13	19	28	10
2022	3	9	12	11
2023	7	11	16	23

No legislation related to Education savings accounts was reported in 2020.
Sources: Education Commission of the States and Moody's Ratings

This is evidenced by laws that enable the use of tax dollars to fund private schools, as well as the proliferation of open enrollment initiatives, which enable parents to send their children to any public school, regardless of where it is located. Examples include interdistrict open enrollment required of all districts in Idaho[7] (Aaa stable) and West Virginia[8] (Aa2 stable).

Legislation that promotes competition by and between school districts, charter schools and private schools has a material impact on district capture rates, or the percentage of school-aged children within a district's boundaries who attend the district. A school district's capture rate is a primary way to assess its policy credibility and effectiveness, another key governance consideration under our ESG framework.

For a K-12 school district, policy credibility and effectiveness is tantamount to its ability to develop and implement policies that enable it to retain and educate its community's students. To the extent that state funding is based on enrollment, enrollment loss can adversely impact a school district's budget. Revenue reduction typically constrains the effectiveness of a K-12 school district.

Most open enrollment legislation relates to virtual academies – online learning platforms for K-12 school districts – and to allowing families to choose an academy regardless of which district operates it. While this is likely a carry over from virtual learning efforts in the pandemic era, it represents further movement toward school choice at the expense of a student's local school district.

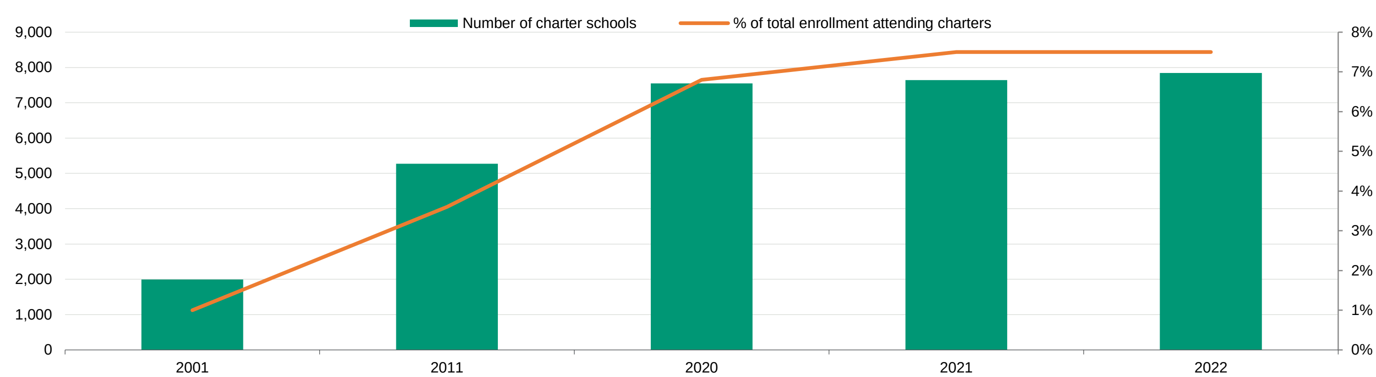
School choice legislation that enables tax credits and tax-exempt education savings accounts has also grown materially over the past three years. And while voucher-related legislation declined in 2022, it grew again in 2023. As of March 2024, 28 states and the District of Columbia have at least one private school choice program, according to an Education Week analysis[9]. Of those states, 12 have at least one private school choice program that is universally accessible to K-12 students in the state.

In addition to increased interdistrict and private school competition, the rapid proliferation of charter schools across the nation adds additional complexity to the K-12 education landscape. Charter schools and related enrollment has grown significantly over the past 10 years (see Exhibit 3).

Exhibit 3

Charter schools and related enrollment have grown significantly

Number of charter schools and percentage of total US enrollment attending them since 2001



Sources: National Center for Education Statistics and Moody's Ratings

Since states generally tie funding to enrollment, a migration of a local school district's students to a charter school may reduce revenue, creating a budget management challenge. This is the case in states like Pennsylvania (Aa3 positive) that have a relatively high number of students attending charter and cyber schools. In Pennsylvania, school districts must pay per pupil tuition - comprised of state aid and local revenue - to charter schools. Cyber schools further exacerbate this pressure because students are not constrained by the physical location of a charter school.

Moreover, a study by the University of Arkansas School Choice Demonstration Project[10] revealed that local K-12 school districts enroll higher proportions of students with disabilities than charter schools. Local school districts are left to grapple with the higher costs associated with the services these students require, which in turn adds to strain on their budgets. If states continue to foster charter school competition through legislative action, that strain will only continue.

Endnotes

1 Enrollment-weighted average of per pupil spending for reporting states

2 Alabama HB123

3 Kentucky SB127

4 California joins small, growing number of states requiring K-12 media literacy, K-12 Dive, November 2023

5 Legislative Tracker: 2024 State Student-Absenteeism Bills, FutureEd

6 These 4 charts explain federal fiscal 2023 K-12 spending, K-12 Dive, January 2023

7 Idaho S1125

8 West Virginia HB2596

9 Which States Have Private School Choice?, Education Week, March 2024

10 Charter School Funding: Little Progress Towards Equity in the City, School Choice Demonstration Project, August 2023

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