

U.S. Municipal Bond Market

Florida's Threats Cause Blowback to Municipals, Debt Service Not Currently at Risk

- Local government or county school-related debt service is not at immediate risk as a result of the recent threats from Florida state officials. Immediate, however, is the operative word. We are unsure of the fluidity of Florida's situation. For now, the larger concern for the municipal bond market is blowback. The threats happening in Florida have a potential precedent-setting nature that could increase the possibility for similar tactics to be used directly and perhaps pressure bondholder security at a larger scale.
- The Florida Department of Education delivered a 48-hour ultimatum to the Florida county school boards that issued mask mandates. Some school boards have ignored the warnings and instituted mask mandates anyway. School aid and compensation could be at risk according to threats.
- Florida County schools can use Rescue Plan Act funds to counter any funds withheld by the state or the governor. Neither the governor nor the state's Department of Education has the ability to block or withhold Rescue Plan Act funds from local governments or schools. Rather than going through the state, these funds flow directly to the local governments and schools.

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Increased Possibility for a Larger Range of Outcomes to the Downside

Bond debt service is not in any immediate danger as a result of the Florida state officials' recent threats. We also do not expect a significantly negative market reaction this week. We do not expect the ratings agencies to move ratings based on these encounters, but we do think they may consider acknowledging to the market what has transpired. The developing situation in Florida could be precedent-setting. Even though the Florida warnings do not pose an immediate threat to debt service, credit, or ratings, they do pose a risk to the decades-long—mostly mutually beneficial—relationship between U.S. state and local governments, including school districts.

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There is blowback from the Florida threats. The unintended consequence is that any future strategies, similar to the threats from recent weeks, increase the range of outcomes—mostly to the downside—where interactions between state and local governments' fiscal matters are concerned. Negotiations are plentiful between state and local governments. There are many agreements that local governments count on to operate. If these agreements come into question or are endangered on a regular basis, it would be an unfortunate turn for the local governments and for municipal investors.

With any luck, the threats from recent weeks will be unique. It is possible they will only be recalled when we recollect the worst of the interactions of 2021, and COVID-19. It is also possible that we have entered a period where a much higher level of uncertainty about security pledges are at issue, even questioned. A development like this could lower investor appetite for some local government and school district bond sales. Let's

hope this time was unique, however during our analysis of future interactions we should still remember last week's threat for what it was, not what it was meant to be.

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Florida BOE Issues 48 Hour Ultimatum

An increasing number of Florida county schools have continued to defy Florida Governor Ron DeSantis' anti-mask policies. Even the [Sarasota County school board voted for a mask mandate](#). The superintendent from Leon County Schools, located in Florida's state capital of Tallahassee, also [announced a new mask mandate on Sunday](#). Here is a [list of Florida school boards and others](#) that have imposed mask mandates. We have previously written about this in [Florida Governor Threatens School Funding if Mask Mandates Remain](#) (Aug. 2) and in [Growing Support for Masking in Schools, Legal Battles May Ensue](#) (Aug. 5).

At the end of last week, [Florida's State Board of Education delivered a 48-hour ultimatum](#) threatening to withhold funds in the amount of the salaries of school board members who defy the governor's anti-mask policy.

U.S. schools [received directly about \\$130 billion of federal relief in the March 2021 Rescue Plan Act of 2021](#), and they are able to use these funds to offset anything the Florida Board of Education or the governor withholds. Over the weekend, U.S. Department of Education Secretary Miguel Cardona reinforced that school districts can ["draw down"](#) these funds for that purpose and state governments [do not have the ability to block these Rescue Plan Act funds from schools](#).

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The History of Strong Cooperation Between U.S. States and Local Governments at Risk

There has traditionally been a strong history of cooperation and support between most U.S. state and local governments. This relationship of course is debatable for some. But, the examples we believe are important for our analysis begin with the substantive programs set up by states that enhance the credit and/or security pledges for local governments, including school districts in some cases. State enhancement programs for school districts exist in many states. These programs are of value to investors because they enhance the security pledge offered. State enhancement for school debt can take the form of state guarantees, state appropriation pledges, intercept mechanisms, and permanent investment funds. [State programs that monitor local government fiscal conditions](#) also exist. They exist in many states in different forms, some with early warning signs. Some states also have early intervention programs for local governments. See the [local government distress policies](#) for all 50 states via Pew Trusts.

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Headline and Political Risk in the Municipal Bond Market

We have seen political risk, even if it was just in the headlines, before in the municipal bond market. Headline risk and political consequences are almost always present when investing in U.S. municipal bonds. Those factors play a larger role in some sectors and places more than others, but they exist, nonetheless. Politics can play an outsized role in public finance. Examples include the 793-day [budget impasse in](#)

Illinois that occurred from 2015 to 2017. Pennsylvania also experienced a nine month long budget impasse in 2015 and 2016. The credit implications of these budget impasses, or similar instances, needed to be considered at the state and local levels at the time.

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This type of political risk has mostly existed mostly in the periphery. They still exist mostly in the periphery, but we are closely watching to see if what transpired in Florida in recent weeks may be precedent-setting in that it increases the potential for unforeseen political risks to lessen bondholder security.

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- Florida Governor Threatens School Funding if Mask Mandates Remain, Aug. 2, 2021

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