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Missouri Direct Deposit Intercept Program - A Closer Look at Missouri's Enhancement Program for Local School Bonds

State of Missouri	Ratings	Outlooks
Missouri Direct Deposit Intercept Program	Aa1/AA+/AA+	negative / stable / stable

Sources: FitchRatings; Moody's; S&P

Most local school district bonds issued in the State of Missouri (current ratings Aaa/AAA/AAA) participate in the Missouri Direct Deposit Intercept Program (MDDP). Created by the Missouri State Legislature in 1995, the MDDP assists local school districts with their capital financing needs by providing credit enhancement for districts' bond issues. Qualifying bond issues earn the program credit ratings of Aa1/AA+/AA+, which are typically much stronger than the local districts' own credit ratings. As a result, enhanced local school bond issues attract more buyers and are issued at lower interest costs than the districts' could obtain on their own.

Missouri school district bonds that are enhanced through the MDDP are typically rated AA+ by S&P. Some issues also carry a program rating from Moody's; very few are rated by Fitch. The enhanced bonds may also carry an underlying rating or ratings that reflect the stand-alone credit quality of the issuing district. Ascent views the MDDP as a useful tool for enhancing credit quality for Missouri bondholders. We do not position bonds solely on the basis of the MDDP rating. We always look through enhancement programs to evaluate the underlying credit quality of the issuing district. Given its proven track record and strong structural features, however, we feel very confident that bonds enhanced by the MDDP will maintain strong market acceptance and will make full payment of principal and interest as scheduled.

The MDDP is a variation on the classic intercept program structure used by numerous states to enhance local district bonds (discussed in more detail in the March 11, 2013 Fixed Income Fundamentals). The MDDP is a "first dollar intercept," meaning that state aid funds flow directly to the bond trustee from the state, and debt service is set aside with the trustee prior to any funds flowing to the district for operations. The Missouri program receives very strong ratings because it contains structural features that ensure that cash will flow to the bond trustee or paying agency in advance of debt service payment dates. In order to qualify a local bond issue for participation in the MDDP:

- The local district bonds must be general obligations of the district, secured by the unlimited property tax pledge of the district.
- The district must receive total annual state aid equal to at least 1.5x the total amount of debt service due on all of its outstanding MDDP-qualified bonds.
- The district must agree to allow the state to make deposits of monthly state aid payments directly to a trustee bank. Once the required 1/10th of annual debt service is on deposit, the balance of the state's monthly aid payment can flow through to the district.
- The district must agree not to pledge the district's state aid as primary security or on parity with the bonds for any other obligations.
- The district must waive all rights to institute any action related to bankruptcy.
- The district must structure the debt service on its bonds such that no payments come due in the first or last month of the state's fiscal year, to protect against any potential for payment delays due to late state budgets (though the State of Missouri has no history of late budget passage).

The main drivers of the credit ratings on the MDDP are the credit quality of the State of Missouri, the state's history of budgeting education funds for local school districts and the mechanics of the program that ensure cash is deposited with the bond trustee. Because state aid for local schools is ultimately appropriated by the Missouri Legislature, the ratings on the MDDP are a function of the G.O. rating of Missouri, adjusted for the risk that the state could reduce or delay payments to local districts. Due to the state's strong track record of timely budgets, relatively stable school funding and no practice of reducing school funding levels mid-year, the program ratings are currently set one notch below the state's AAA G.O. ratings. The MDDP ratings move in tandem with the state's ratings and will never equal or exceed Missouri's G.O. ratings because state aid payments are subject to appropriation by the legislature.



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