Charter School Bonds: A Long-Term Financing Solution

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Public Charter Schools
Borrowing with Tax-Exempt Bonds
What can be financed with tax-exempt bonds?

**Capital Expenditure Projects**

- Acquisition or construction of a facility or project
- Land, buildings, equipment and/or related infrastructure
- Funds may be used to reimburse the charter school for amounts already expended
- Limitations: must be owned by the charter school or CMO or by a governmental entity, and not used in a way that would constitute “unrelated trade or business” or in the business of another person or entity

**Refinancing Prior Debt**

- Refinance outstanding taxable debt acquired in connection with capital projects
- Construction financing, New Markets Tax Credit financings, bank loans and mortgages
Why use tax-exempt bonds?

**Compared to Taxable Debt**

- Generally, lower interest rates than private loans or bank financing
- Longer-term (up to 35 years) than most taxable debt
- Less onerous and restrictive covenants

**Compared to Governmental Financing Programs**

- No stringent eligibility requirements (e.g. procurement procedures, bidding rules, ongoing compliance provisions, mandated government ownership)
- No multi-month application process
- Projects can be fully funded (100% financing)
Why use tax-exempt bonds? (cont)

Compared to Federal Tax Credit Financing

• No restrictions on geographic location or student population served
• No statutory limit on the dollar amount of tax-exempt bonds that may be issued
• Structured as long-term financings (up to 35 years) instead of short-term financings (7 to 15 years)

Compared to Accumulated Funds and Contributions

• May invest accumulated funds in taxable obligations earning higher rates of return

*Every public charter school’s circumstances are unique, from the scale, timing and location of a project, to the resources available and accessible, to a school’s specific financial management and programmatic objectives. School leaders and stakeholders need to analyze the various facilities financing options in view of their specific circumstances in order to determine the best option.*
When should the process take place?

Three Timing Situations

1. **Separate Construction and Permanent Financing**
   - Obtain short-term (1 to 3 year) construction loan
   - Pay off construction loan with proceeds from long-term tax-exempt bonds

2. **Combined Construction and Permanent Financing**
   - Issue long-term tax-exempt bonds before construction begins
   - Borrow to pay initial interest payments during construction period
   - Bondholders assume construction risk; must disclose detailed project plans

3. **Acquiring a Completed Facility**
   - Typically acquire from a charter school developer (nonprofit or for-profit) once construction project is near completion
How does it work?

Legal Documents

CHARTER SCHOOL   Loan Agreement   ISSUER   Bond Purchase Agreement   UNDERWRITERS

Indenture

TRUSTEE

BOND INVESTORS

Flow of Funds

CHARTER SCHOOL   Bond Proceeds   ISSUER   Bonds   UNDERWRITERS   Bond Proceeds

Bond Proceeds

Loan Repayments

PROJECT

TRUSTEE

BOND INVESTORS

Bond Debt Service Payments
Who do you need for your financing team?

Underwriter

- Structures the bonds for successful marketing to the investor community to ensure the lowest interest rate possible for the charter school
- Serves as original purchaser of all the bonds
- Underwriter selection is critical to success of the transaction

Issuer

- Governmental entity actually issuing the bonds and making the loan to the charter school
- Coordinates public hearings required under local law and tax law
- Examples include: (1) a local industrial development authority or joint power financing authority, (2) a local government entity (city, county or school district), (3) special issuer with national financing power such as Public Finance Authority (Wisconsin), IDA of Pima County (Arizona)
- Important legal analysis required before selecting an issuer
Who do you need for your financing team? (cont)

Lawyers

**Borrower’s Counsel – represents the charter school in the transaction**

- Responsible for reviewing and negotiating provisions of all documents to which the charter school is a party
- Will provide an opinion regarding the tax-exempt status of the charter school, the validity of the actions it has taken to approve the financing, and its good standing under state law, among other matters

**Bond and Disclosure Counsel – represents the Issuer, however, typically chosen by the charter school**

- Responsible for approving the legal structure, drafting the legal documents and conducting tax due diligence (as bond counsel)
- Responsible for drafting the public market disclosure document and conducting finance and operations due diligence (as disclosure counsel)
- Will provide an opinion on the validity and tax exemption of the Bonds
Who do you need for your financing team? (cont)

**Trustee**

- A national trustee bank that collects, maintains and disburses the moneys in connection with the bonds
- Enforces the rights of the bondholders if a default occurs

**Rating Agency**

- Ratings are an important part to ensure marketability of the bonds
- Standard & Poors and Fitch are the two more active rating agencies that analyze and rate municipal bonds. Moody’s not active in the sector in recent years.

**Rebate Analyst and Post-Issuance Compliance Monitor**

- There are post-issuance responsibilities that the charter schools will have, and these companies will assist with compliance
- Responsibilities include continuing disclosure, covenant compliance, calculation of rebate liability to the IRS and completion of the IRS Schedule K
How do you position yourself for market access?

Satisfy Rating Agency Criteria

- Rating agencies have changed the way they analyze the credit worthiness of a charter school as the charter movement has evolved and matured
- Current rating criteria take into consideration factors both within and outside of the control of the charter school, highlights include:
  - **Program and Market Position**
    - Strongest if the charter school serves a specific need in the enrollment area that competing public schools do not serve
    - Sufficient demand for the program is evidenced by a well-documented and regularly updated waiting list
  - **Management Team and Organizational Structure**
    - Management team with a broad array of organizational expertise, including programmatic, financial, managerial, operational and legal knowledge
    - Over-dependence on the skills of one founder can jeopardize a charter school’s longevity
How do you position yourself for market access? (cont)

Satisfy Rating Agency Criteria (cont)

- **Financial Management and Operating History**
  - A minimum of three to five years operating history, ideally having successfully completed at least one charter renewal process
  - Strong financial management evidenced by maintenance of operating reserves, adherence to existing reserve policies, effective cash flow management, regular oversight and reporting, financial contingency planning for unexpected challenges, expenditure flexibility and a strong history of budgeted to actual performance

- **Debt Management and Financial Planning**
  - Strong revenues compared to current and anticipated debt
  - Management policies and practices and projections related to the incurrence of new debt
How do you position yourself for market access? (cont)

Satisfy Rating Agency Criteria (cont)

- **Strong Bondholder Protections in the Transaction Legal Provisions**
  - Mortgage lien on the financed facility
  - Maintenance of a debt-service reserve fund
  - Restrictions on future incurrence of long-term debt
  - Covenants to maintain operating revenues at a specified level over expenditures

- **Authorizing Statutory Scheme**
  - Viewed as strongest with impartial review and approval process for new and renewing charter applications
  - Length of charters (longer is better)
  - Level of oversight and communication (more frequent is better)
  - Predictability of state funding (more predictable is better)
  - Specific relationship with chartering authority (good working relationship is better)
How do you position yourself for market access? (cont)

Meet Investor Expectations

- Typically, charter schools do not interact directly with their ultimate “lenders” (bond investors). Underwriters maintain investor relationships and act as the interface between the charter school and the investor community.

- **Governance and Leadership**
  - Board of directors that is independent from the CEO
  - Qualified individuals across key areas of expertise
  - Growth plans should be supported by an analytical framework

- **Charter Management Organizations**
  - No preference to stand-alone public charter schools vs CMOs
  - For-profit CMO’s profit motive tends to weaken managed school balance sheets
  - Self-sustaining revenue model is best
How do you position yourself for market access? (cont)

Meet Investor Expectations (cont)

• *Enrollment and Revenue Projections*
  - Strongest projections are based on conservative assumptions
  - Based on organic growth of the school population matriculating up
  - Credibility and knowledge of the school’s leadership

• *Subjective Factors/Site Visit*
  - Opportunity for investors to meet school leaders, to understand their vision and how they execute the school's mission
  - Parent involvement, engaged faculty and staff, and happy kids who are learning
  - Alignment of architectural design and project scale to the school’s program and financial capability
Meet Investor Expectations (cont)

• **Quality of Finance Team**
  - Familiar with all of the most active underwriters and legal counsel
  - Reputable, experienced professionals are known to many investors and lend a measure of credibility
  - Wary of financial market participants that mislead schools

• **Other Considerations**
  - History of charter school revocations within the state
  - Parent surveys, third-party generated school “report cards”
  - Searches through Google for publicly available information