

**LOCAL INITIATIVES SUPPORT CORPORATION**  
**CHARTER SCHOOL TAX-EXEMPT MUNICIPAL BOND DISCLOSURE TEMPLATE**  
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## **I. Introduction**

Local Initiatives Support Corporation (“LISC”) and its Educational Facilities Financing Center (“EFFC”) support quality public charter schools in low-income neighborhoods as part of LISC’s community development work across the country. LISC has gained significant insight into the needs of charter schools while working in the sector the past 16 years and found that accessing facilities financing on affordable terms remains one of the largest impediments to the development of high-quality charter schools.

In an effort to provide greater transparency to charter school bond market participants, with the ultimate goal of expanding the capital markets for charter school facilities in the absence of a broad public solution, LISC has published a series of comprehensive reports on the sector. With support from the Bill and Melinda Gates Foundation (“BMGF”), LISC released *Charter School Bond Issuance: A Complete History, Volume 1* in 2011, providing the first comprehensive listing of tax-exempt charter school bond issuances through year-end 2010, including detailed analysis of their pricing. *Charter School Bond Issuance: A Complete History, Volume 2 (“Bond Research”)*, published in November of 2012, examined the academic, operational, and financial drivers of credit strength and risk for charter schools and the metrics for measuring them. The report also analyzed the credit characteristics of charter school borrowers at the time of issuance, the current financial strength of bond-financed charter schools as reflected in audited financial statements for Fiscal Year 2011, the repayment performance of these borrowers, and evaluated the disclosure provided in charter school bond offerings.

As part of LISC’s 2012 research on disclosure practices, it concluded that certain critical information was frequently either missing or incomplete. Indeed, the focus was often on information not germane to evaluating charter school credit risk, such as economic and demographic information for the resident school district, county, state, and even the nation.

While disclosure has improved materially from the very early transactions executed in the late 1990’s, examining even those offerings issued in 2013 shows certain information still missing from many official statements, particularly detailed academic results. This situation may be due – at least in part – to lack of general agreement among market participants of the key credit criteria and underwriting standards when assessing charter schools. This uncertainty is reflected in the 2011 changes to rating criteria by Fitch Ratings as well as the soon to-be-released National Federation of Municipal Analysts’ draft, Recommended Best Practices in Charter School Financings.

With volume hitting record levels in 2012 and 2013 – resulting in a doubling of the sector in the last seven years— coupled with the phenomenal growth that the sector has experienced, the demand by charter schools looking to access the tax-exempt market is likely to remain strong and overall sector volume will likely continue to expand.

Given this state of the charter school bond sector — with greater volumes expected in the future while the material disclosure gap continues to exist — with additional funding from BMGF, LISC has created an official statement template as an addendum to the *Bond Research*. This disclosure template shows critical data that we believe gives a very clear roadmap to underwriters and charter school borrowers allowing them to produce a disclosure document that should enable the greatest possible investor community review for new transactions. Expanding the number of potential investors typically results in reduced borrowing costs, thereby allowing schools to invest more in core educational programs.

With the best practices highlighted in this template, market participants – investors, underwriters, rating agencies, bond and underwriter’s counsel, conduit issuers, states, municipalities, and charter schools and their authorizers – can adopt consistent and standardized disclosure practices that will benefit the charter school sector as it continues to scale.

This template shows critical data and specific examples that we believe highlight best practices in charter school bond financing disclosure. To create this template, LISC used an official statement from an RBC Capital Markets underwritten transaction that was generally comprehensive in nature and inserted excerpts from other disclosure

documents, that combined, create an example of what we consider to be ideal disclosure for the vast majority of charter school transactions. Due to the combined nature of the information, the reader should review each section as independent information, i.e. not necessarily consistent with other sections. Examples include a debt service schedule that details principal of \$30 million while a separate discussion of project costs may only total \$12 million supported by another appraisal section that may show a value of \$5 million. Likewise, a discussion of statutory provisions in “Sample State” may be inconsistent with a separate discussion of competing schools in the City of Philadelphia. In addition, wherever possible, we made states, cities, and schools generic in name. We have listed the underwriting firms whose disclosure was excerpted in the order of information used.

The template makes recommendations on what should be incorporated into a charter school bond disclosure statement, and below are highlights and explanations on the best practice recommendations:

### **Academic Results**

- Standardized test results, by grade
  - Academic performance is a fundamental factor in charter school underwriting. It drives enrollment, financial strength and charter renewal. It is impossible to assess credit strength or risk without a measure for, and disclosure of, this key factor. While disclosure has improved over the sector’s history (with some still missing information on student results, focusing instead on educational philosophy, curriculum and other educational inputs), there is significant variation in both the magnitude and type of academic performance data provided in many official statements. Our 2012 research found that the percentage of offerings which included comprehensive multi-year academic performance data averaged only 45% from 2008-2011.
  - The preference is to include comprehensive reporting of multiple years of academic results on mandated tests disaggregated by grade and by subject as appropriate, together with host district, state, and neighboring school comparables; also include a discussion of adequate yearly progress (AYP) and the school’s report card. Disclosure of improved performance data in a more standardized form will enable market participants to directly evaluate academics and greatly clarify what constitutes a quality school.

### **Corporate Governance and Management**

- Board Governance
  - As with all not-for-profit organizations, a charter school’s corporate governance and management are critical underwriting components. Disclosure documents should include the school’s mission as well as the following details on its Board composition: member names; qualifications; tenure; and, term expirations, in order for the reader to evaluate the diversity of the Board’s experience as well as how long the members have been affiliated with the school. The discussion should also disclose how frequently the Board meets, how other oversight practices are carried out, and how policies and procedures are implemented. Further, minutes from Board meetings should be made available either via the school’s website or as part of the offering documents.
- Management
  - The offering document should focus on school management, particularly a detailed description of the qualifications and experience of key administrative personnel and their tenure. Any conflicts of interest, particularly as they relate to the facility purchase and construction, if applicable, should be disclosed as well as the school’s formal conflict of interest policy.
- Third Party Management Organizations
  - If a school is managed by a third party management organization, the disclosure statement should contain a detailed description of the selection process as well as the company’s qualifications, term, and compensation. In addition, a summary of the third party management contract should be included, with the actual contract made available to investors.

### **Enrollment**

- Given that charter school bonds are secured with per pupil revenues, enrollment data is another key underwriting variable. As such, information should include comprehensive historical and projected enrollment numbers by grade. Particularly for those schools that receive per pupil funding directly from one or more school districts rather than from the state, enrollment by school district should be included. Per pupil amounts can be vastly different among school districts.

- Historical and projected information should be shown on the same chart but clearly delineated so the reader can more easily assess the school's past, current, and projected enrollment. Generally, the inclusion of both headcount and the budgetary equivalent reflected in historical financial performance and employed in pro forma projections is most informative.

### **Waitlist Information**

- Charter schools typically maintain waitlists for students who would like to attend the school, but did not receive spots through the lottery process. Waitlist quality varies based on the frequency that the school updates the list. However, the size of a school's waitlist is important from an underwriting perspective both because it is an indicator of academic quality (thereby demand) and because the school can draw upon its waitlist to maintain enrollment. Our disclosure analysis concluded that only 59% of the offering documents contained waitlist information. Offering documents should include a detailed historical waitlist by grade and a description of how the school manages its waitlist, i.e. the frequency the list is updated and which grades are entrance points for newly enrolled students.

### **Facility Information**

- As a school's facility serves as the primary collateral for bondholders, a description of the current facility and/or the new project should be included in all offering documents. Details should include the age of the facility, its condition and location, capacity constraints, grades served, as well as the number of classrooms and the presence of specialized space, e.g. cafeteria, gymnasium, playground, parking, etc. A discussion of how the purchase price was determined, if applicable, should also be included. For new construction projects, the offering statement should also include a discussion of the general contractor, guaranteed maximum price, if applicable; permit process, and the team's experience in constructing new school facilities on time and within budget.
- Appraisal Information
  - In order for investors to get a sense of the collateral facility's value, particularly a summary of an independent appraisal conducted by a MAI (Member Appraisal Institute) designated appraiser should be disclosed. The full appraisal should also be made available to investors.
- Environmental Reports
  - A summary of Phase I and II, if applicable, should also be included in the disclosure document with actual environmental reports made available to investors.

### **Financial Information**

- Audited financials
  - A borrower's audited financial statements are a fundamental component of any offering document and it is standard practice to include such historical financial data in charter school bond offerings. An official statement should include at least **three** years of audited financial statement. Our research found that approximately 5% of the offering documents failed to include audited financials.
- Quarterly financials
  - In addition to the audited financials, the most recent quarterly unaudited financials should be included in the offering document as even the most recent audited information can often be over a year old.
- Budget
  - The current school year budget, with comparisons to actual revenue and expenses, along with next year's budget, if developed and approved, should also be included in the disclosure document to allow the reviewer a sense of the school's most recent financial performance and how well-managed the school's budgeting process is.
- Per pupil funding levels
  - As per pupil funding represents the overwhelming majority of charter school revenue, current and historical per pupil funding levels should be detailed in the offering document. If the school receives funding based on school district spending and educates students from more than the district in which the charter school is located, the data should include funding levels from all such school districts with the percentage of students from each.
- Philanthropy
  - Any reliance on philanthropy should be disclosed since any reduction in this revenue source could negatively affect the ability of the school to meet debt service requirements. Ideally, the offering statement should detail the school's history and reliance on philanthropic sources of revenue.

- Detailed Debt Service Schedule
  - While debt service schedules are typically found in disclosure documents, a more detailed schedule with six month intervals, and a total for each fiscal year, is preferable. In addition, the disclosure document should include a description of other debt, if applicable, including short-term cash flow notes, as well as other long-term obligations, including leases that may be relevant to the school’s ability to meet required debt service on the bonds. Finally, the document should offer a description of any future capital plans.

### **Legal Information**

In addition to describing the transaction’s security features, the disclosure document should contain information on the following:

- State’s charter school statute and education funding process
  - Because every state charter school statute is different—and those differences can be significant—each offering statement should include a detailed summary of the applicable charter school statute to give analysts and investors a sense of the key provisions that a school must adhere to, including renewal, revocation, oversight, and funding parameters. Likewise, each state has different education funding processes and these should also be fully described.
- Authorizer renewal requirements
  - Because different authorizers within a state may have different rules, each offering statement should include a summary of authorizer renewal requirements and the school’s history of renewal, if applicable. The authorizer’s overall statistics, e.g. number of authorized schools, number and percentage of schools closed due to non-renewal or revocation should also be disclosed.
- Charter document
  - Whenever possible, the disclosure document should include the school’s actual charter so that analysts and investors have all of the school’s applicable operating parameters. If the length of the document makes it burdensome, the document should be made available to investors.
- State Intercept Program
  - A number of states offer intercept programs to charter schools that enhance bondholder security. In some cases, money sufficient for bond debt service goes directly from the state to the trustee. In other cases, particularly for those schools that are paid directly by school districts, if revenue due to the charter school from the school district is not received in a timely manner, the charter school may petition the state to intercept monies owed to by the state to the school district to instead be redirected to the charter school. The details of any such intercept program should be detailed in the disclosure document. If not automatic, the frequency and reasons why the schools have had to utilize the state intercept should also be discussed.
- Litigation
  - Describe any material litigation that may affect the school’s competitive position and/or finances.

### **Multi-Year Pro-forma Projections**

- Multi-year financial projections, or pro formas, are an important budgetary tool for schools and a critical underwriting component. These projections should show line item operating revenue and expense items on a cash basis together with underlying assumptions regarding enrollment and growth that are both reasonable and detailed. They should also clearly state debt service coverage, debt burden, and use of capitalized interest, if applicable. A time horizon of at least five to seven years—in addition to the budget year— is optimal from an underwriting perspective, constituting the intersection of strategic forward planning and realistic assumptions. Our research indicated that only 82% of the offering documents contained pro formas.

### **Relationship with Authorizer**

- Authorizers, of course, play a critical role in the life of a charter school. The opinion of the authorizer will determine the fate of the school and whether or not the school will receive its charter renewed. With this in mind, it is preferable for schools seeking facility financing to be able to show evidence of a positive relationship with its authorizer. Examples of a positive relationship include a history of renewal(s) and an approval for enrollment expansion—either via additional grades or simply adding students to currently established grades.
- Ideally, an evaluative report from the school’s authorizer regarding the school’s academic performance will be available and, if so, should be included in the disclosure document to provide valuable underwriting information. In addition, a good standing letter from the school’s authorizer should be included with the offering documents.

## **School Operations**

- School Affiliates
  - Any affiliated entities of the charter school, including charter school management organizations and foundations, should be clearly disclosed in the offering statements to give the reader a better context of the school.
- School Age
  - A school's age provides the context for all other disclosure provided as part of the offering document. It is not possible to assess enrollment trends, academic achievement progress, likelihood of charter retention, or soundness of financial position without the identification of the date the school was established clearly stated upfront in the Summary. Our research found that while the inclusion of age was fairly universal, it was not always clearly stated or easy to find.
- Charter Expiration Date
  - A school's charter expiration date is a key piece of information that should be stated clearly up front in the offering statement.
- Curriculum
  - A school's curriculum focus, such as language, music, or technology, should be described in the offering statement and whether the school is using Common Core standards.
- Demographics
  - The offering statement should also include demographic data on the student body, particularly the percentage of students who qualify for free or reduced lunches. This information puts the school in context, particularly when comparing academic performance against those of local and state medians.
- Attendance
  - Attendance statistics are another key underwriting criterion as quality schools typically have a consistent record of high attendance rates, i.e. well over 90%. The offering statement should disclose attendance statistics of at least three years and preferably since its inaugural year. Any material swings should be explained.
- Competition
  - The environment a charter school operates within is another important credit factor. Whether the school is the sole charter school in the area or one that operates in a city with a significant percentage of charter school students should be clearly described. A comprehensive list of all area schools that may compete with the charter school should be part of the offering statement. The list should include traditional district schools, other charter schools along with parochial schools, and private schools, and their current tuition rates, if applicable. In addition, the offering statement should describe school's relationship with the local school district(s), particularly for those schools that receive per pupil funding directly from school districts.
- Student and teacher retention
  - High-quality schools—public or private, at the college level or K-12—typically have strong retention statistics for both students and teachers. High turnover of faculty or students is a red flag and reason to investigate such circumstances.
- Faculty
  - Quality teaching is likely the most important factor in student academic achievement. As such, the offering statement should describe teaching staff qualifications, along with salary ranges, bonus potential—with comparisons to local school district, along with any future compensation agreements, and union representation, if applicable. In addition, staff benefits, including any retirement programs, should also be described.
- Grade configuration changes
  - Any grade configuration changes should be clearly stated in the offering statement. Often successful elementary schools will apply to its authorizer to add middle school grades. Likewise, successful K-8 schools may request approval to expand to high school. These changes are credit positives. Conversely, an explanation is crucial for those schools that were once K-8 but now offer only elementary grades.
- Transportation arrangements
  - Discussion should include transportation options including who is responsible for busing costs—the school or the host school district—as well as which students are eligible for transportation.
- Insurance

- As with all enterprise activities, proper insurance is essential to credit quality. Charter school insurance coverage should include property, casualty, general liability, professional liability, errors and omission, theft, and business interruption insurance—the latter particularly important to revenue-dependent charter schools that find themselves temporarily unable to use their facility.
- Parental involvement
  - Describe parental involvement, including whether family volunteering is required. Discuss parental involvement including the existence of a Parent Teacher Organization. Highlight any family volunteer expectations, particularly if there is a family volunteer requirement that must be met in order for a student to continue to attend the school.

### **Secondary Market Disclosure**

- Ongoing disclosure is critical to the bond market and in order to access financing, charter school borrowers typically agree to submit comprehensive information periodically to the market via the trustee and Electronic Municipal Market Access, or EMMA. Analysts and investors use this information to conduct credit surveillance on a regular basis. Specific secondary market data generally includes financial-related information including audited financial statements, quarterly balance sheet, income statement, cash flow statement, budget, and debt service coverage, and liquidity levels, i.e. days cash on hand. Other required information include enrollment, wait list, faculty information, changes in school leadership, and material correspondence with the school's authorizer.

### **Special Acknowledgements:**

LISC would like to thank Susan Gundersen and Nora Etienne for providing editing assistance to complete the Bond Disclosure Template.

