Charter Lenders & Charter Authorizers: Can We Talk?

National Association of Charter School Authorizers (NACSA)
and **Local Initiatives Support Corporation (LISC)**

contents

Introduction: Getting to Know You

Any charter school operator who has borrowed money to build or renovate a facility knows that lenders ask tough questions—not just about bank accounts but also about trustee boards, enrollment rates, and academic performance. Sometimes the school has already reported the same information to the authorizer that granted its charter. Eliminating duplicative reporting would be reason enough to get lenders and authorizers talking to each other.

That's just what happened when NACSA and LISC recently convened a Working Group of charter school authorizers and charter facilities lenders. The group examined how their respective sectors evaluate charter schools. Despite their differing purposes, they found significant common ground, as well as some notable differences and distinct obstacles to greater sharing of information.

Most important, these discussions made clear that whether looking at charters to evaluate a potential loan or for purposes of public accountability, lenders and authorizers both want to see strong, high-quality schools that become sustainable by doing a great job of educating students and being able stewards of public money and public trust.

The intent of this paper is to widen that conversation to a broader audience of lenders and authorizers by familiarizing each side with the basic concerns and methods of the other. We hope this paper will be particularly useful to those encountering the complicated world of charter school facilities finance for the first time: for authorizers interested in learning more as their schools enter the lending market, or for lenders interested in serving the charter market but who need help understanding how schools are governed and where to find reliable performance reports.

The following pages look at the major players on each side, how they operate, the analyses each undertakes, and what their interests are. It examines where they differ, as well as commonalities between authorizers and lenders, and suggests some pathways for more productive and transparent communication in the future.

Improved communication and collaboration may certainly help avoid unnecessary duplication. We believe it can also focus authorizers and lenders on their shared vested interest: the success and sustainability of the schools they support.

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At a Glance: A Lot in Common

Lenders seek to originate loans and investments that generate solid risk-adjusted returns and help charter schools meet their financial goals.

Authorizers are looking to develop portfolios of quality charter schools for the jurisdictions they serve.

While we recognize that their goals are not the same, authorizers and lenders do share some similar interests and practices.

- ✅ **Both** look for sound financial management.
- ✅ **Both** have an interest in seeing that schools operate in buildings that are suitable to the needs of their academic programs and that are not financially burdensome.
- ✅ **Both** need timely, reliable information to make their respective decisions.

Here's a list of the operational, financial, and academic information both institutions consult when making decisions. (For more detail, see Table 2 on page 30.)

LENDERS & AUTHORIZERS OFTEN USE THE SAME DATA...
Enrollment by Grade, Annual and Planned
Student Applications / Wait List Count
Test Scores
Organizational Chart
Board Terms, Succession Plans
Teacher Retention
Liquidity (i.e., number of days or months of operating expenses held in cash)
Debt Burden
Personnel and Occupancy Expenses
Transparency Indicators (open meetings, board votes on major contracts, rules on conflicts, etc.)

The Unique Context of Charter Accountability

Public charter schools are held accountable for their performance in many of the same ways as other public schools. Their students take state tests, the schools are graded in their states' accountability reports, and they're subject to consequences for violating applicable public laws.

Charters actually have additional layers of accountability not shared by their district counterparts. Although autonomous in operation, they answer to authorizers, the state-sanctioned entities that approve and oversee charter schools. Authorizers evaluate the schools' performance against the goals in their charter contract, and against state laws and academic standards, to determine whether the charter can be renewed and the school remains open.

Charter schools are publicly funded, but they obtain less per-pupil revenue than other public schools, and the gap is especially acute in the area of facilities funding. So they often call upon private-sector lenders to provide funding needed to build, purchase, or renovate their buildings.[1]

Of course, charters are not alone in going to private lending markets for facilities financing; virtually all traditional school districts do the same. But in many states, districts benefit from building aid that's not made available to charters, and district bonds are backed by property taxes. That means they usually get better ratings, which lower the overall borrowing cost.

Before making a decision to loan money, lending institutions engage in due diligence to assess the charter's prospects and develop agreements for ongoing reporting from the school. This adds another layer of accountability for charter schools: in order to obtain funding and to remain viable while paying off a loan, they must produce high academic achievement for students, and they must handle money prudently.

Lenders and authorizers ask many of the same questions about charter school governance, management, and performance. Both share an interest in financially viable, high-quality schools. Authorizers must regularly evaluate and report on charter school performance against established standards—and lenders should be able to consult these reports to determine whether particular charter schools are sound investments.

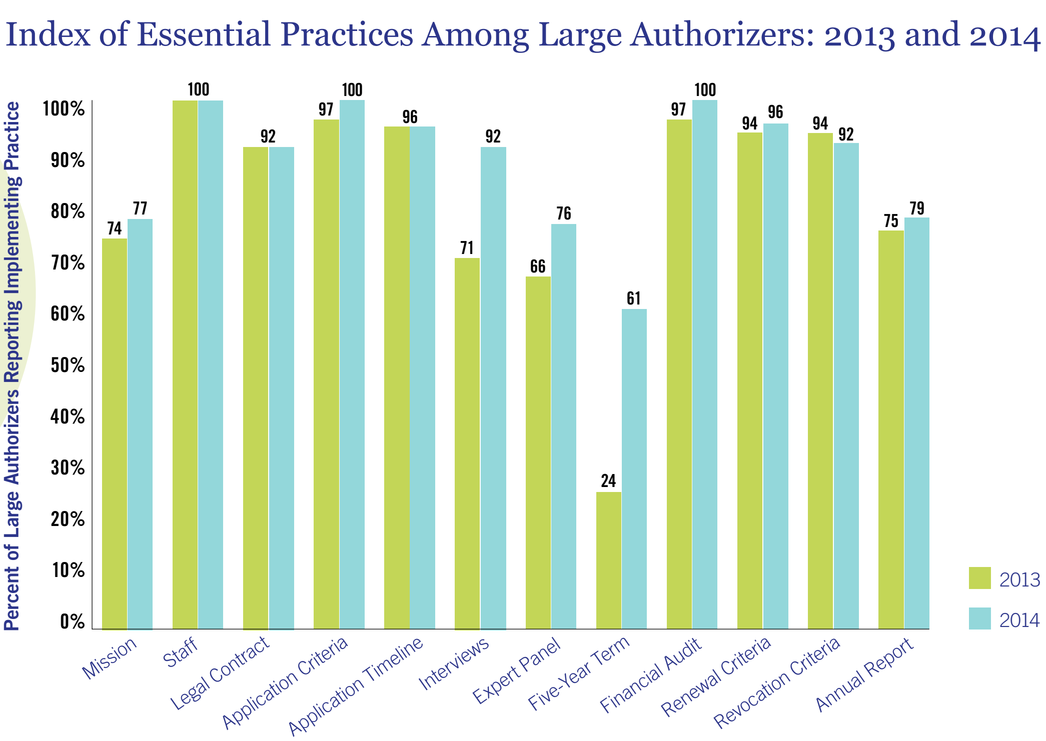
Yet according to research by the Local Initiatives Support Corporation (LISC), very few bond investors and underwriters pay attention to authorizer findings: *"Authorizer evaluations of the school's academic performance, developed pursuant to the authorizer's ongoing monitoring and renewal processes, were also extremely informative; however, there were only six of these evaluative reports in the 393 [bond] offering documents [LISC analyzed]. Instead, the documents frequently contained lengthy original charter authorizations, which reflect goals rather than actual performance or progress in meeting goals."*[2]

Surveys by the National Association of Charter School Authorizers (NACSA) show that the proportion of authorizers implementing its recommended practices is already impressive and grows with each passing year (see Figure 1 on page 4). That means most authorizers are conducting rigorous application processes and doing conscientious oversight—so there should be plenty of information being generated.

NACSA'S ESSENTIAL PRACTICES FOR AUTHORIZERS

1. Have a published and available mission for quality authorizing
2. Have staff assigned to authorizing within the organization or by contract
3. Sign a performance contract with each school
4. Have established, documented criteria for the evaluation of charter applications
5. Publish application timelines and materials
6. Interview all qualified charter applicants
7. Use expert panels that include external members to review charter applications
8. Grant initial charter terms of five years only
9. Require and/or examine annual, independent financial audits of its charter schools
10. Have established renewal criteria
11. Have established revocation criteria
12. Provide an annual report to each school on its performance

FIGURE 1. **Authorizers Increasing Use of Essential Practices**



The risk of closure is an essential part of the calculus in charter lending and will be explored later in this report. But lenders should understand that the actual percentage of schools closed in any given year is rather low.

Here are the closure rate statistics for 2012-13 and 2013-14 among schools overseen by “large” authorizers—those with 10 or more charters in their portfolios—that account for approximately three-quarters of all public charter schools.

TABLE 1. **Closure Rates among Large Authorizers**[3]

Closure Rate Type	2013-2014	2012-2013
Overall Closure Rate	3.8%	3.8%
Closure Rate During Renewal	8.0%	11.8%
Closure Rate Outside Renewal	3.2%	2.3%

Source: NACSA 2013 and 2014 surveys of large authorizers

» Overall, 3.8 percent of all charter schools overseen by large authorizers were closed during 2013-14, regardless of whether the closures happened during or outside the renewal processes.

» Of the charter schools that were up for renewal as their charters reached the end of a term, 8 percent were closed.

» Another 3.2 percent of charters active in 2013-14 were shut down outside of a renewal process—in other words, their charters were revoked or surrendered in mid-stream, often for financial or operational defects.

The key point here is that most closures, of all kinds, are predictable if you keep an eye on performance. Later on we will explore how authorizers make renewal or closure decisions and the kinds of information they rely on during the process.

The Charter Lending Community

Different kinds of charter schools have different growth patterns that drive different financial needs. A community-based charter will often start with a couple of grades and then add a grade each year as students advance. That school may lease space (perhaps making some improvements along the way) and then at full enrollment may decide to build or buy its own facility. A school affiliated with a management company may start with a larger complement of grades or perhaps an entire K-8 span. That school will need to think bigger and spend faster, right out of the gate. Some charters prize the personal touch and want to stay small. They may simply rent a modest facility but may also have a school model that demands more recreational space or an elaborate chemistry lab.

The challenge for each type of school is to find the best deal possible for its specific needs. But unless school leaders are experienced in facilities finance or are working with an expert consultant, the process of finding that deal may be somewhat bewildering. There are many possible entry points to that marketplace, and people there speak a different language than that of educators.

Therefore, we begin with a brief primer on the three main players in the charter finance marketplace: 1) not-for-profits, 2) banks, and 3) bond investors. These groups differ in their approach to financing charter schools based on their missions and funding sources, but they look for a lot of the same information when determining whether charter schools, Charter Management Organizations (CMOs), and properties to be occupied by them add up to worthwhile investments.

1. THE NOT-FOR-PROFIT SECTOR

LISC periodically reviews the landscape of charter facilities financing, and its 2014 report offers this succinct summary of the not-for-profit sector of this market:

> *"…[T]here are 29 nonprofit organizations that provide significant facilities assistance to charter schools in the form of grants, loans, guarantees, real estate development and technical assistance. Three foundations have committed to facilities financing on more than a localized basis, providing grants and program-related investments (PRI) to help finance charter school facilities. Twenty-three nonprofit organizations provide financing for charter school facilities as part of their community development or charter support missions. Four organizations provide real estate development services, including one developer that also provides credit enhancement and loan financing for charters. Seventeen of these 29 organizations have received support totaling $219 million from the [U.S. Department of Education] Credit Enhancement Program, and 18 have been awarded a total of $5.9 billion in NMTC [New Markets Tax Credits] allocation by the Community Development Financial Institutions (CDFI) Fund of the Treasury Department. These private nonprofits have collectively provided $2.1 billion in direct financial support to charter schools for their facilities needs."*[4]

Community Development Financial Institutions (CDFIs)

CDFIs are lending institutions that gain this designation after successful application to the U.S. Treasury Department. They're often driven by a mission to provide capital for organizations that work in low- and moderate-income communities. According to one analysis, "As of November 30, 2010, there were approximately 907 certified CDFIs in operation in the United States, including 572 nonprofit loan funds, 197 credit unions, 72 CDFI banks, 41 bank holding companies, and 25 venture funds."[5]

Charter schools are a natural fit for CDFIs, because they often serve disproportionately high numbers of low-income students and are generally concentrated in disadvantaged urban centers. These organizations are funded by a mix of grants, program-related investments, and loans from banks and other financial institutions. They are also eligible for support from the Treasury Department's CDFI Bond Guarantee Program, which since 2013 has provided $525 million of long-term capital for community and neighborhood development and in many cases has enhanced the ability of CDFIs to back charter facilities projects.

CDFIs offer charter schools a variety of financial products. These include short-term loans to acquire, build, rehabilitate, and make leasehold improvements for charter school facilities. CDFIs also make bridge loans that tide schools over until grants arrive, as well as loans for furnishings, equipment, and technology. In situations where charter schools experience problems in short-term cash flow, CDFIs can originate working capital lines of credit. In addition to these direct financial supports, CDFIs play an additional role by providing financing to real estate development companies (both not-for-profit and for-profit) that develop space to be leased to charter schools. Finally, a few CDFIs develop real estate themselves and then lease or sell it to charter schools.

CDFIs may have greater flexibility than other types of lenders to help with leasehold improvements, which are fixed asset financing rather than real estate financing and often have much shorter repayment terms. The limited marketability of leasehold improvements can limit their collateral value for conventional lenders.

CDFIs typically take a more expansive view than other institutions as to what constitutes "equity." Where banks and bond investors tend to consider only cash and liquid assets as equity, for example, some CDFIs also include startup grants, work credits equity, and other assets.

CDFIs earn income from the interest paid by a charter school borrower to the CDFI as lender. They also earn origination fees (often one percent of the loan amount) and rental income if they own the property.

2. BANKS

Banks are federally insured entities that take deposits and make loans. Even with the spread of national brand banks, local bank offices that have deep community ties are often the first stop for charter borrowing. Yet, the modest volume of local charter school borrowers in any particular community, weighed against uncertainty about this relatively new borrower type, may keep some local banks from taking the plunge.

It is difficult to pin down just how much lending is done by banks to charter schools, in part because of the banking industry's own regulatory and reporting processes. Banks send periodic reports (known as "call reports") on their corporate condition and financial status to their respective regulators, but there is no separate category in these reports for loans to educational borrowers, let alone to charter schools specifically. And the North American Industry Classification System (NAICS) codes, used by rating agencies to establish financial benchmarks for various industries, lump charters in the same category as private and parochial schools.

Because banks offer the public a range of financial services and products, they may benefit from a charter school's use of these other services—for example, depository accounts, lines of credit, administration of a retirement plan for the school, and mortgages or other loans originated to staff members at the school. However, banks may be less flexible than CDFIs on financing terms and conditions. As regulated entities, they're required to meet certain rules about loan-to-value ratios or LTV—the ratio of the size of a loan to the value of the asset it will be used to purchase.

There will always be exceptions, but as a general rule, the LTV range for a traditional bank will be lower than that for a CDFI. For example, a bank lender might use an LTV ratio between 60-75 percent, where a CDFI might call for 80-100 percent, depending on the project and funds used. In that case, a CFDI loan will mean that the school will need less cash up front.

The other key ratio used by banks and other lenders is the debt service coverage ratio, which calculates the ability of the borrower's net operating income for a specific period to cover the proposed debt service for that period. Generally, lenders require coverage exceeding the actual or projected debt service by a margin of 20 percent or more to ensure that cash flow will be adequate to service required loan payments. (In the language of lenders, a 20 percent margin requirement would be expressed as a debt service coverage of "1.2 times" or "120.")

The Community Reinvestment Act

One key difference between CDFIs and banks is that banks receive credit under the Community Reinvestment Act (CRA) for charter school loans that meet their regulators' criteria for low- and moderate-income communities. This is an important incentive: bank CRA reports are available to the public, and a CRA rating can be a major factor in receiving regulatory approval for bank mergers or new branch locations.

CRA is a 1977 law that requires banks to provide financing in low- and moderate-income areas (and to low- and moderate-income people) in the geographic markets where they operate. The act applies to banks but not to CDFIs (which often operate in comparable areas). However, in order to obtain CRA credit, many banks lend to CDFIs—and this is a source of income that CDFIs use to fund their own lending.

3. TAX-EXEMPT MUNICIPAL BOND MARKET

Although banks and CDFIs make charter loans throughout their lifespan, charters are more likely to seek loans from them in their formative years, when they have between three and five years of operating experience and need help with startup and initial facilities costs. Although there are exceptions, they tend to turn to the tax-exempt sector of the public capital market (or the "bond market") later and for larger amounts. LISC's 2012 review of nearly 400 tax-exempt bond offerings found that the typical charter school at time of issuance had been open 6.4 years.[6] That figure does include some bond financing for newer schools—which may carry additional risk and result in higher interest rates, a shorter loan term, or special covenants, such as more frequent reporting.

The tax-exempt bond market provides long-term financing, which may include acquisition, rehabilitation, and construction of a charter school facility. Where loans extended by CDFIs and banks are often three to ten years in length, charter school bond investors regularly purchase bonds with up to 30-year (or longer) maturities. Bond investors are typically most concerned about the borrower's ability to pay its debt service. Banks and CDFIs view charter school facilities deals as real estate transactions and generally require some equity contribution from the borrower within a loan-to-value ratio of 80-90 percent. Bond investors can exceed 100 percent LTV if there is a solid case that debt service will be paid.

Charter school bond investors are drawn to this market because of the bonds' tax-exempt nature. This term means that owners of the bonds do not pay income tax on the interest income they receive for holding them. As a result, the interest rate charged to the charter school (as borrower) is lower than a typical taxable loan of the same maturity. (The discount in the interest rate charged to the school is roughly equivalent to the bond purchaser's tax rate.)

The charter school bond market has been outpacing the general municipal bond market in recent years. "While charter school issuance set records in both 2012 (an increase of 38.5%) and 2013 (an increase of 18%), the overall municipal market was down 12.1% in 2013,"[7] LISC found. Transaction size has been growing briskly, rising to an average of $16.9 million since June 2012, compared to $11 million prior to that date—an increase of more than 50 percent. Although some charter bond issuances are as low as $2-3 million, the average size ranges between $10 million and $20 million per transaction in most states.[8] And LISC notes that "[t]he tax-exempt charter school bond sector has now grown to over 730 transactions totaling $9 billion and is poised to pierce the $10 billion threshold within 2014."[9]

Because most schools that access bond financing are borrowing funds for larger or simply more costly projects, these transactions are relatively rare in the overall scheme of charter facilities borrowing. With more than 6,500 charter schools in the country, fewer than 10 percent of them have accessed the bond market. Bond investors active in this market are essentially mutual funds funded by individual and corporate investors.

The small but growing pool of institutional bond investors mainly comprises high-yield bond mutual funds, but in recent years the sector has actually been moving toward a more balanced mix of high-risk/high-yield bonds and those that are rated "investment grade" (representing relatively low risk). This has been fueled by the decisions of several active charter states, such as Texas, Utah, and Colorado, to permit charter schools to access state-based credit enhancement vehicles, enabling those bonds to obtain AAA ratings. Without such vehicles, those same bonds might receive a lower investment-grade rating. This kind of state cooperation helps save the schools millions of dollars in interest costs.

In the bond market there is another kind of institutional player involved, as well. Whereas CDFIs and banks contact schools and CMOs directly about potential transactions and financing terms, bond investors are approached by investment banks (bond underwriters), which act as an intermediary between the school and the investor. Investment banks earn an underwriting fee by identifying a school or CMO that might make a qualified borrower, structuring a loan transaction, and placing the bonds with investors.

Issuance and purchase of tax-exempt bonds involves the collaboration of numerous parties, including a governmental bond issuer (i.e., a municipal agency), underwriter (i.e., a regulated broker-dealer which identifies investors), a corporate trustee, and attorneys for all parties. (See Figure 2, page 11.)

Risk and Reward

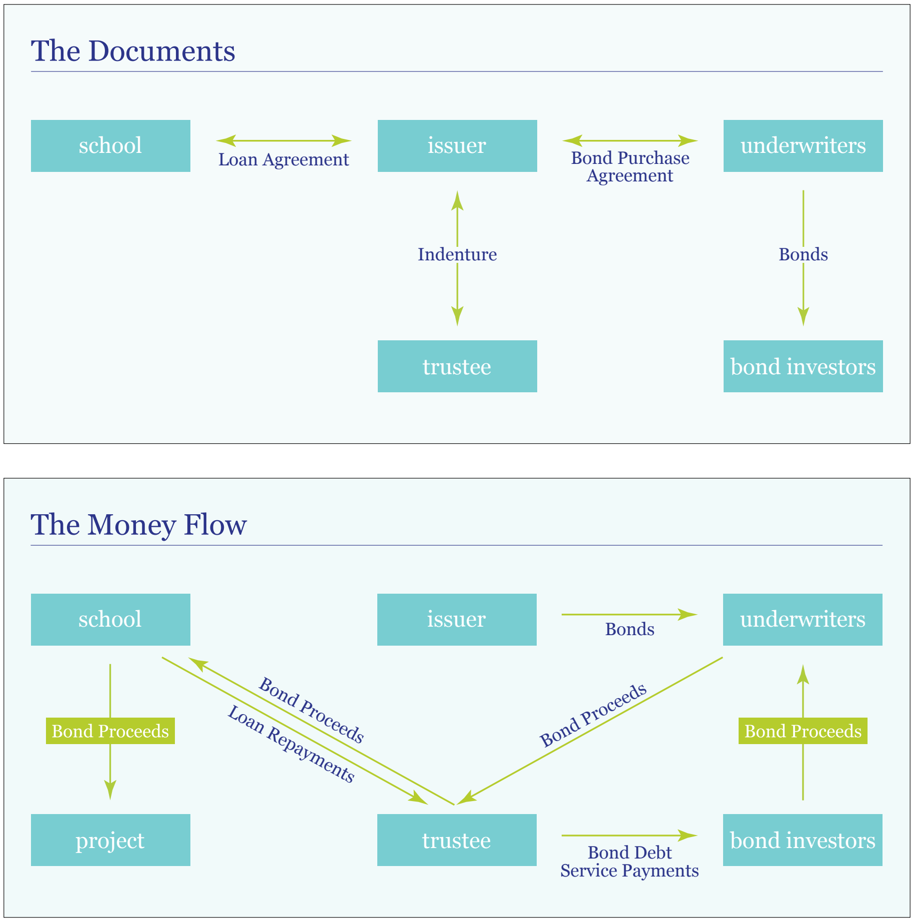
What attracts bond purchasers to the charter market is the relatively high yield on charter school bonds, and that's related to the perception of risk. Although charter school loan defaults happen less frequently than is the case in other sectors, charter schools often receive lower ratings from the rating agencies (i.e., Moody's, Standard & Poor's, and Fitch) because they're a less-established asset class of the overall municipal bond world. According to the Wall Street Journal, "Charter-school debt is riskier than general-obligation bonds—a category that includes debt issued by traditional public schools—because charter schools don't have the power to raise taxes like the districts overseeing traditional public schools."[10]

Charters face more acute political risks than more established categories of bonds. Changes in state accountability policies, financing, and personnel issues can have an impact on their ability to perform.

Finally, there is the simple fact that charters operate in an environment of high accountability. Their continued existence depends on satisfying the requirements of their charters and reducing or eliminating compliance problems that could result in premature closure.

While the bond financing described here is typical for the capital markets accessed by investment bankers, an alternative is also available. Commercial banks will make direct purchases of tax-exempt and taxable charter school revenue bonds and hold them in their commercial loan portfolios, rather than broker-dealers selling them to third-party investors. Direct purchases, also called private placements, eliminate the need for underwriters and ratings from the rating agencies, as banks establish their own internal risk rating in their underwriting process. Direct purchase also allows the bank to gain CRA credit in these cases, and since the terms of bonds purchased directly are negotiated between the borrower and the bank, there may be lower closing and administrative costs.

FIGURE 2. **How a Charter School Bond Deal Is Structured**



Source: Orrick, Herrington & Sutcliffe, LLP © 2012

Beyond Loans

Banks, CDFIs, foundations, and other financing organizations use a variety of other tools and subsidies in providing real estate financing for charter schools, including

» New Markets Tax Credits (which provide federal tax credits as returns to equity investors in charter school real estate and other qualifying transactions);

» Credit Enhancement grants from the U.S. Department of Education (which make riskier loans more attractive by allocating cash to transactions as additional collateral); and

» Program-Related Investments, made by foundations "to support charitable activities that involve the potential return of capital within an established time frame"[11]—in this case, advancing the mission of providing suitable facilities for public charter schools.

This is by no means an exhaustive list. For more information about the range of financing tools used in support of charter schools, see LISC's 2014 Charter School Facility Finance Landscape: http://www.lisc.org/docs/resources/effc/2014CSFLandscape.pdf

The Lending Process

There are some basic routines for all kinds of lenders in how they approach a school's request for a loan, although the process will vary by lender type. Lenders first seek to understand the proposed project, the sources and uses of loan funds, and the source(s) of repayments. Upon receipt of initial financial data, a lender will review the transaction within their organization and decide whether to move forward.

Banks and CDFIs will typically draw up an initial term sheet that lays out basic conditions for a proposed loan. (See Term Sheet Items, Appendix III.) If the term sheet is acceptable to the school, the lender will order third-party reports on the project (including appraisal and environmental review), hire outside counsel to document the transaction, and fully evaluate the project and the charter school itself to identify risks and potential mitigants. Once a final underwriting package is complete, the bank or CDFI will seek internal credit approval to originate the loan and then will send a commitment letter proposing an interest rate and schedule for repayment.

For bond deals, the procedure is different. An investment bank first evaluates the projects, then structures the transaction and prepares disclosure documents, then offers the bonds to investors. Once the offering has attracted buyers willing to invest at a certain price, the bond purchasers sign an agreement obligating them to deliver the funds.

In either case, once funds are committed, the lender and school work together on finalizing legal documents for the transaction to close, allowing funds to flow.

Lenders should provide schools with clarity about their procedural obligations. For example, certain up-front costs will be paid out of pocket but may be reimbursable. The school's trustee board, however, must pass a reimbursement resolution to get such costs reimbursed from bond receipts.

WHAT LENDERS LOOK FOR

Despite differences in the terms of loans provided by CDFIs, banks, and bond investors, these groups have many similarities in their review and analysis of charter schools.

Real Estate. Lenders view providing debt financing in terms of "ways out." In evaluating whether or not to make a loan, a lender will consider its first, second, and third sources of repayment. For charter transactions, the first source of repayment is cash flow from the school's operations. If the school were to stop paying, the lender would be able to exercise its right to liquidate any collateral, which may include cash reserves or the school's real estate. It could also collect from guarantors such as foundations or board members—although such guarantors are actually rare in charter lending.

As they structure a transaction, lenders will clarify ownership: Will the school itself own the land and building? Will it be owned by a Charter Management Organization (CMO)? Or will it be owned by a special purpose entity created by the school or the CMO with some kind of leasing arrangement? The lender will also clarify which entities are involved in the financing. On some transactions, a school will hire a third-party real estate developer to perform development services on a "turn-key" basis, unless the school is handling those tasks itself.

A prospective lender will want to know the financial capacity of the development firm, and will also ask about qualifications of the general contractor. Additionally, a lender will need to confirm whether or not the school itself is overseeing construction or if it has hired a construction manager or owner's representative. If a general contractor is running the project, a lender will want to understand the agreement in place between the school and the general contractor (e.g., is it a guaranteed maximum price contract?). Lenders will inquire about whether or not there are any environmental concerns about the site where the property is located and how those concerns are being addressed. Lastly, lenders will inquire what the school's operating plan is if the proposed building is not ready for use when the school year begins.

What Happens to the Assets?

Critics of charter schools have raised alarms about the property of public charter schools remaining in private hands after a school closes. Although there is a blend of public and private interests involved in all public school real estate financing, the elements are in sharper relief here, because charter school facilities deals are not mediated through the conventional channels of state and district capital budgets. Charter schools must wage capital campaigns, but donor contributions usually pay for only a portion of construction costs, which are then used to leverage more significant loans. Those loans will be paid back with public funds: either a dedicated stream of facilities dollars (provided by only 13 states) or more typically, a portion of the school's operating funds.

If a charter school shuts down, how are the interests of private investors and public stakeholders—taxpayers—reconciled?

In order for investors to support public construction (of any kind, not just charter schools), they must have assurance that the loans they make will be paid back. State charter laws typically include a provision concerning disposition of assets that try to balance the legitimate security interests of lenders with the state's interest in retaining assets paid for in part by public dollars.

Exactly how this happens will differ according to state laws and specific situations. Most states allow lenders to include in their contracts a mortgage lien stating their security interest in the property. This means that upon a default, lenders can claim all of the sale proceeds—up to the mortgage amount—if the lender chooses to sell the building.

If a borrower is actually in default on a loan (which could be one reason for having to close the school), a foreclosure proceeding may ensue, in which the lender receives title to the building or can force a sale. »

CONTINUED

But let's say a school closes for academic reasons, but is up to date on its mortgage payments. The lender may first look for another charter school or other tenant to occupy the space. If the building can be leased, rental income can substitute for some or all of the loan's debt service. If the building is sold, sale proceeds will be used to pay down the mortgage loan—although lenders rarely recover the full amount outstanding.

However, there are some circumstances in which the state may indeed lay claim to the property if a charter school closes:

» One is the case of co-location in district space, where the district clearly owns the school buildings and provides space through a lease (as in New Orleans) or a memorandum of understanding (as in New York City). Leaving for another day the ultimate question of who should own and deploy public school space, current law provides that in these cases, the closure of a charter school means that the space reverts to the district, even if the charter has made leasehold improvements at its own cost.

» A second exception occurs in states that directly support charter bonds (as noted above) through state-based credit-enhancement programs. Here, even in the case of new construction, the state's guarantee may be structured in a way that confers a right to the property in case of default.

However state and local laws treat dissolution of assets, the issue should also be addressed in the charter contract itself. This is a suggested approach from NACSA's model charter contract template:

> *"E. Disposition of School's Assets upon Termination or Dissolution. Upon termination of this Contract for any reason or if the School should cease operations or otherwise dissolve, then, at the sole discretion of the Authorizer, any assets owned by the School, including tangible, intangible, and real property, remaining after paying the School's debts and obligations and not requiring return or transfer to donors or grantors, or other disposition in accordance with state law, will become the property of the Authorizer."*[12]

RISK ANALYSIS

Because charters can be revoked or non-renewed, lenders must also consider what happens if the charter school is shut down. Are there any alternative uses of the building? Or are there other charter schools in the market that could take over the space, and if so, what price would those schools be willing and able to pay to purchase it? If there are no other charter schools that could take over the space, does the property's appraised value for alternative uses support the proposed loan amount?

Assessing risk is partly a financial calculation based on projected enrollment and demand and partly an evaluation of whether the school is operating a quality program and whether its leaders exhibit strong management capacity. But there is also *political* risk: the possibility that external forces will work against sustainability. This can mean everything from literal politics, as in a divided state legislature that must approve the level of charter funding, to support or antagonism from the local community.

Are authorizers a risk?

For many lenders, *authorizers themselves* are the biggest question mark in the category of "political risk." Lenders worry that an unfriendly authorizer will go after a charter for reasons unknown. They may get apprehensive after seeing that an authorizer has closed other charter schools in the recent past.

Both authorizers and lenders can agree that low-quality schools are a risk and shouldn't stay open. But if lenders choose to operate in an environment where they know that some schools will close, they will hope that authorizers will base those decisions on performance standards and charter obligations rather than political whim. Closures shouldn't come as a surprise, and "political risk" coming from authorizers can be minimized by transparency in accountability policies and intervention practices.

To that extent, authorizers that establish clear, objective, measurable, and uniform performance expectations for their charter schools minimize the risk of political decision making. Authorizers that fail to establish such expectations actually *increase* the risk of political decision making.

How do lenders evaluate the strength of a charter school and assess the level of risk in any given loan?

Lenders often take one basic step, seeking from the authorizer a "letter of good standing" offering assurance that the school remains in the authorizer's good graces. But such letters are *de minimis* documents because an authorizer might face liability if it provides too rosy an assessment on a school that subsequently fails. So an authorizer may simply say, "At this moment we have no active plan to revoke the charter." What these letters cannot tell is how the school's performance trajectory looks and whether the authorizer is aware of issues at the school site that don't currently rise to the level of intervention but might at a later point.

Rather than asking for an open-ended assurance, some lenders ask more specific questions to assess risk, for example:

» Is the school currently the subject of a financial emergency review or currently operating under any corrective action plan or financial recovery plan?

» Is the school the subject of any other review, investigation, or audit by the authorizer, or to the authorizer's knowledge, any other governmental entity?

» Within the last year, has the school timely filed with the authorizer all FTE (Full-Time Equivalent) surveys, audits, and other documentation required to receive funding?

What are other common questions asked by lenders?

Beyond asking for authorizer assurances in these areas, lenders do some serious homework of their own before deciding to proceed with a loan. Many of these questions will be familiar to authorizers who structure oversight through a performance framework that looks at a school's academic, financial, and organizational soundness.

Academic

» How has the school been performing academically (in the most recent school year and multiple years) based on state-mandated tests disaggregated by grade, subject, and student subgroup?

» How does the school's performance compare to that of the host district, neighboring schools, and schools serving similar populations?

» How does the school rank in the state accountability system (for example, an A through F grade based on multiple evaluation factors)?

» How do the graduation and college-acceptance rates compare to the local district?

» Is there a consistent record of high student attendance?

» What are the qualifications of the teaching staff?

Financial

» How do the school's financial projections fit within standard lending criteria and ratios for charter schools (e.g., total personnel expenses as a percentage of total revenue)?

» How well does the school budget align with actual expenses and revenues? Are conservative assumptions used for the budget?

» What portion of the overall budget is spent on rent or facility-related debt service? Does the school have the financial capacity (i.e., liquidity and net worth) to support the proposed project if there are cost overruns during construction or expenses exceed the school's budget once it is operating?

» What are the school's income and expense trends during the past several years?

» If charitable contributions are required to pay debt service, does the school have a history of consistent fundraising at the required level?

- Does the proposed transaction have any third-party credit enhancement?
- Does the school have sufficient levels of insurance?
- Will the school be able to reach its targeted enrollment?
    - What is the school and/or CMO's history of attracting students?
    - How much of a decline in enrollment could a school withstand and still afford its debt service?
    - What has the net attrition rate been in the past?
    - Is there a waiting list and how many non-duplicated names does it contain (i.e., families that have not applied to multiple schools)?
    - Is the school actually approved by its authorizer to serve the enrollment anticipated in its operating projections and building plan?

Organizational

- What is the quality of staff and management, including leadership and board membership?
    - What is the relationship between the school, its board, and any CMO (whether for-profit or not-for-profit)?
    - Which group or individual is responsible for which decisions? Does the school's board have the authority needed to oversee the management contract?
    - Are the governance and management arrangements free from conflicts of interest?
    - Can the school survive without its current leadership? Is there a succession plan for key personnel?
    - Does the school have a robust teacher recruitment plan? What is the rate of teacher attrition?

The External Environment

- What is the authorizer's track record in terms of charter renewals and closures?
- Has the school been renewed? If not, what criteria will the authorizer use to review the school—and is the school well positioned for renewal?
- What is the political outlook for charter schools within the school district where this one is located?
    - Is there opposition from other interest groups?
    - Are charters a contentious issue within the state, and do they have champions among elected officials who can defend against political attacks?

Common Core Impacts

In most of the 43 states currently embracing the Common Core State Standards, the standards themselves have been in place for four school years. In the 35 states that have also adopted assessments aligned with the Core, developed by one of two national testing consortia (Smarter Balanced and PARCC [Partnership for Assessment of Readiness for College and Careers]), 2015 is the year when the results of these more rigorous tests will begin to count for state accountability purposes.

In the few states that have administered early versions of Core-aligned tests, notably Kentucky and New York, standardized test scores immediately dropped, although scores are stabilizing in subsequent years. Anticipating this volatility, NACSA has urged charter authorizers to maintain year-to-year accountability by consulting multiple measures (test and non-test based) and by evaluating the performance of a given school in relation to that of an authorizer's entire portfolio. Steps such as these help to compensate for fluctuations in outcomes that are driven by test changes and not by real differences in a school's actual performance.

In their own due diligence, lenders should be aware of whether a given state is participating in Common Core; which assessments it will use (including home-grown versions not produced by the two national consortia); whether the state will "pause" accountability consequences while adjusting to the new scores; and how the state and the authorizer are each planning to accommodate the accountability transition.

For more on this topic, see NACSA's series "Transition to the Common Core": http://www.qualitycharters.org/publications-resources/common-core.html

Authorizing Mission and Tools

Authorizers and lenders ask many of the same questions, though with different emphases and for different purposes. Here we consider what drives authorizers to pursue their version of inquiry.

Charter school authorizers have a well-defined mission. According to NACSA, three core principles form the foundation for quality authorizing:

1. Maintain high standards for schools
2. Uphold school autonomy
3. Protect student and public interests

Authorizing is still a young profession and still working to develop or refine practices that manifest these principles in effective oversight. Most of the time these practices are in sync with the needs of lending institutions, but not always.

A conscientious authorizer may find that the only way to protect students' interests is to close their failing school—even though a lender may have invested substantial sums in its facility. In seeking to protect a charter school's autonomy, an authorizer may insist that its board have sufficient latitude to terminate a management contract, even if that introduces a note of uncertainty into a lender's view of the school's stability. Although both authorizers and lenders are cognizant of state academic standards, the authorizer may include additional performance measures for a school with a distinct or unconventional mission—measures that a lender might view as overly prescriptive.

The best way to resolve these tensions is transparency about what the school is actually being held accountable for and the methods authorizers will use to gauge its progress and inform high-stakes decisions. Lenders can call on this information to make well-informed judgments. With real transparency, there should be strong alignment between the authorizer's findings and the lender's perception of risk.

What lenders may not know is that there is an architecture of accountability—a set of tools and processes that every authorizer should possess and use to understand how well schools are performing, tell that story concisely, and make sound decisions about renewal, closure, and charter revocation. The following section covers the basics.

THE CHARTER

Every financing deal should begin with analysis of the charter agreement itself. A strong charter (or "charter contract") spells out not only the school's mission, identity, and term length, but also its material terms, compliance obligations, and performance expectations. The charter should provide clear indication of what it will take for the school to be renewed. It should also spell out the authorizer's obligations for oversight, the processes by which accountability measures will be evaluated, and in the few states where mandated by state law, the authorizer's obligation to provide specific kinds of technical assistance.

Because charter documents are written under the requirements of different state laws and because there is wide variation in the quality and depth of those documents, a few caveats should be kept in mind:

- Some charters are cursory and incorporate by reference a host of laws, regulations, and policies without spelling out how they actually pertain to the school. These cases may require a detailed conversation between authorizer and lender about whether and how the authorizer actually calls on these provisions in its accountability practice.
- Sometimes a “charter” is nothing more than an approved application document—which makes accountability confusing because the broad promises and long-term goals in a charter application don’t provide an explicit basis for accountability. In some states, however, this is a requirement of law, so to clarify expectations, some authorizers develop additional accountability provisions in a memorandum of understanding (MOU).
- A charter may simply be a legal contract accompanied by a separate “accountability plan” or “goal statement.” These should have the same contractual force as a charter, but it’s wise to confirm that with the authorizer.
- Finally, and most important, the charter is necessary but not sufficient to understand the school’s status. Lenders who simply look at a charter’s mission statement or check the term length are not carrying out adequate due diligence.

Looking at a road map is a good place to start, but you have to check the gas and kick the tires, too. In the following section, we look at how authorizers determine whether schools are roadworthy.

MEASURING ACADEMIC PERFORMANCE

The three basic domains by which authorizers evaluate schools are academic, financial, and operational performance. Of these, academic performance requires the most nuance and relies most heavily on state-level data (although that is often supplemented by evidence the school collects on its own). Under the No Child Left Behind Act (NCLB, 2002), states were required to document student proficiency measured against an ever-elevating bar. They were also required to disaggregate performance by student subgroups (ethnic minorities, low-income students, those in special education, and so on). If a school missed the bar on any of these measures, if would fail to make “Adequate Yearly Progress” or “AYP.” Although this term was designed to indicate which schools needed to improve, it became a common, blunt-instrument measure of whether a school was succeeding or failing.

Beginning in 2011, the Obama administration has granted waivers from NCLB’s accountability requirements, but only if states produce their own version of rigorous accountability systems. So far, 42 states and the District of Columbia have won waivers, so there is growing diversity in accountability approaches. It’s important that lenders understand the specific requirements of a state in which the charter school operates.

For example, many states are moving to so-called "index" systems where schools are awarded grades from A to F or from 1 to 5 based on a set of individually weighted measures. Those measures will always include student proficiency on reading and math tests and usually growth (although that is calculated in different ways); they may incorporate other metrics, such as graduation rates, performance in science, and how well a school is closing achievement gaps between advantaged and disadvantaged student populations. An overall "B" may mean one thing for a school that enrolls an affluent, college-bound population and something else for a school that specializes in dropout recovery. Knowing which is doing a good job means understanding the state's systems and being able to tell whether a school's students are making strong year-to-year growth, even if they're not yet hitting the desired target on pure proficiency.

States are required to publish school-level report cards, and much can be gleaned from a trip to the state education department's website. (Bear in mind, though, that report cards are a "lagging indicator" based largely on the last cycle of testing.) Most charter schools are required to produce annual reports on their own performance, and about 65 percent of charter authorizers provide separate annual reports on each school.[13] These often go beyond the minimum requirements of state report cards; NACSA recommends that they align with the expectations outlined in the charter agreement.

Performance Frameworks

According to NACSA's most recent survey of charter authorizers, 90 percent of respondents said they use some kind of performance framework as the core of their accountability program, although about one-quarter of authorizers simply rely on the state's accountability framework.[14]

Frameworks cover each of the three accountability domains (academic, financial, and organizational) and include a series of specific metrics designed to track a school's progress against the domain-specific goals stated in its charter. Frameworks state how those metrics will be measured, the annual targets to be attained for each measure, and ratings (Meets, Exceeds, etc.) that describe the level of performance.

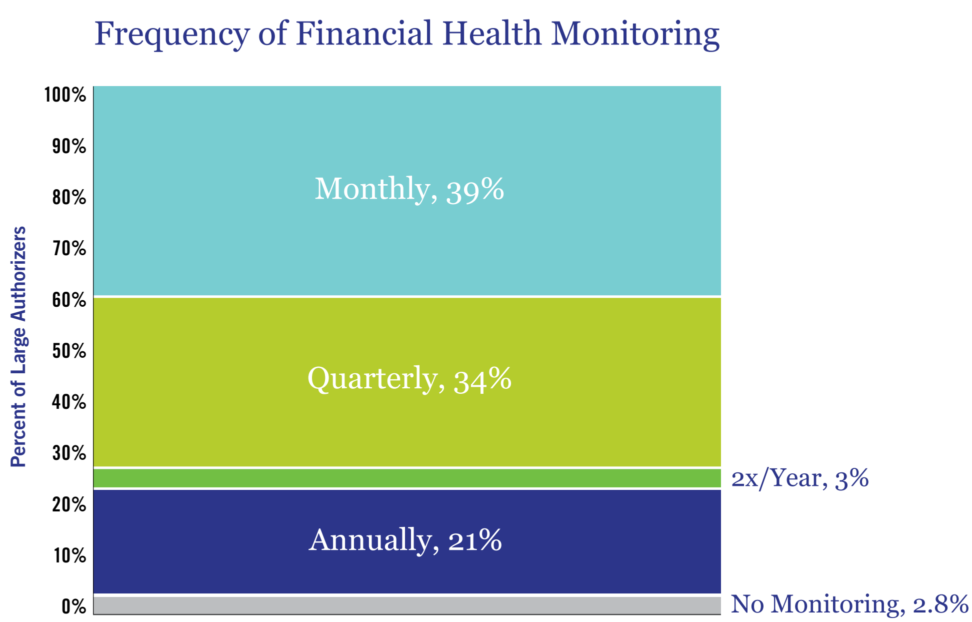
In looking at academic progress, for example, a performance framework will take each of the school's charter goals (including performance on any state-mandated assessment but also including mission-specific measures) and create annual performance targets for the entire school and for distinct student populations. Looking at this data can provide a much keener sense of how a school is doing—not just whether it received an A or B on last year's state report card, but also how well it is performing against its own charter goals. Moreover, it can disclose specific shortcomings that may be of critical importance. For example, in a school whose mission is to serve a population of recent migrants, the school should be excelling against its annual targets for English language learners (ELLs). Similarly, a school organized around an arts-infused curriculum should be able to show annual growth in performance and understanding of various art forms—while also meeting its targets in reading and math. (See sidebar on Performance Frameworks.)

FINANCE AND OPERATIONS

Discussions of charter schools' financial accountability often center on the nearly universal requirement for an annual audit. But audits are retroactive and sometimes don't tell the story of current performance and viability. And they're just part of a broader picture.

Authorizers must evaluate financial viability and sustainability when considering whether to approve new schools, over the course of the charter term, and at renewal. But most authorizers also conduct interim financial oversight (sometimes mandated by state law) that may include review of annual budgets and collecting monthly or quarterly financial statements. According to NACSA's 2014 authorizer survey, 73 percent of large authorizers report monitoring the financial health of charters in their portfolio monthly or quarterly.[15]

FIGURE 3. **Authorizers and Financial Health Monitoring of Schools**



A strong framework for evaluating financial performance will identify measures monitored by the authorizer on a monthly or quarterly basis and provide clear metrics and practices to distinguish acceptable from unacceptable status (for example, a minimum of 3 months' operating cash on hand, presence of internal controls, and conservative budgeting practices). This kind of analysis is often done by lenders in underwriting—but is also done routinely by many authorizers.

An organizational framework includes indicators that speak to the quality of management, systems, and routines for running the school day to day. Some of the most important indicators deal with the charter's governing board, beginning with what a strong board looks like. A recent Vanderbilt University study of charter startups recommended: *"[T]he ideal governing board is comprised of 7-11 members, each of whom is able to substantively contribute to school operations. CSOs* *and founders repeatedly recommended having a diverse board that includes members with the following areas of expertise: finance and accounting; real estate and facilities; legal and human resource services; fundraising; marketing; community partnerships; and academic programming."*[16]

Apart from composition, does the board function well in overseeing the school's compliance with state law, financial viability, and progress toward its charter goals? How often do they meet? Are they respecting open meetings laws? Do they vote on budgets and other major decisions? Do they have functioning, well-defined committees? Does their treasurer require periodic reporting, including budget-to-actuals? Is there a succession plan for the board and the school executive?

Finally, an organizational framework deals with what are known as compliance issues: Do teachers meet state certification rules (if any)? Does the facility have a proper certificate of occupancy? Are enrollment tallies turned in accurately and on time?

Performance Frameworks

NACSA works with authorizers to develop their own performance frameworks and has published a guide giving detailed illustrations of how frameworks are constructed and used and the types of data they contain here (available only to NACSA Members; become a NACSA Member here).

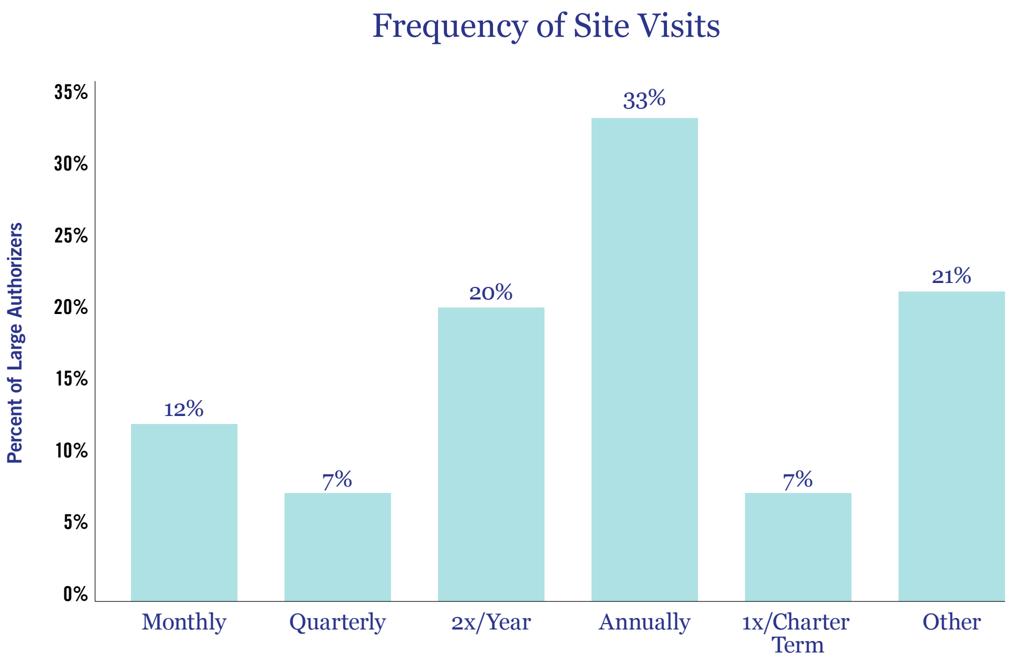
Here is an example from the academic framework, showing metrics for student performance compared to those of schools the students might otherwise attend.

Measure 3d **Are students in the school performing well on state examinations in comparison to students in schools they might otherwise attend?**
Exceeds Standard: ☐ School's average proficiency rate exceeds the average performance of students in schools they might otherwise attend by 15 or more percentage points
Meets Standard: ☐ School's average proficiency rate meets or exceeds the average performance of students in schools they might otherwise attend by up to 15 percentage points
Does Not Meet Standard: ☐ School's average proficiency rate is less than the average performance of students in schools they might otherwise attend by 1–14 percentage points
Falls Far Below Standard: ☐ School's average proficiency rate is less than the average performance of students in schools they might otherwise attend by 15 or more percentage points

SITE VISITS

Among authorizers there is a range of views about site visits. Most conduct site visits for renewal purposes, and in fact, a substantial majority conduct them on an annual basis or more frequently. Some do not conduct any site visits except at renewal or when they receive reports of problems at the school site; for many of these authorizers, outcomes are their only concern and they view site visits as "process," not outcomes.

FIGURE 4. **Authorizers and Site Visits**



Done properly, site visits can provide authorizers with additional evidence about whether a school is on-track toward meeting its goals. In addition to verifying compliance, site visits can also serve as an important asset in promoting program quality. They provide the school with valuable feedback from a critical friend.

Authorizers may engage firms specializing in school reviews to conduct their site visits. If they do them in-house, authorizers often supplement their own staff with experts attuned to a school's model and mission—for example, asking a successful Expeditionary Learning school leader to visit a campus using that program.

Site visit reports are often included in documentation considered by the authorizer at renewal time. But they serve a more direct role when reports are provided in correspondence back to the school, which can then work to fix any problem identified. Legally, site visit reports are public documents, even if not posted for general viewing, and should be available to lenders upon request.

INTERVENTION POLICIES

Surprise closures are a sore point among lenders, and rightly so. It's rare that an authorizer closes a school out of the blue with little or no prior warning—but it can happen and most often for good cause. An authorizer has an obligation to shut down a school when the safety of its students is compromised or when some dire operational condition is disclosed—for example, a loss of financial viability that renders the school unable to pay its teachers.

But it's also true that some authorizers lack the systems needed to make sure that problems are discovered *before* high-stakes actions are taken. That's why a growing number of authorizers are creating graduated tables of interventions that spell out the specific deficiency in performance or operations, the steps the school must take to cure it, a timeline, and the consequences if they do not respond adequately.

Intervention policies go by a variety of nomenclatures, but typically begin with low-level issues and advance to those most serious. A school may receive a "notice of concern" if evidence is uncovered that it has failed in one instance to identify an incoming ELL student; if the problem is not remedied and it becomes clear that the school systematically denies services to such children, then a major violation is involved that puts the charter at risk. To be clear, it remains the school's responsibility, as an autonomous entity, to rectify the issues identified by the authorizer.

Every step in an intervention process, including a step to modify or remove conditions, is a public action. But lenders may need to ask *how* these notices are made public. An authorizer may delegate to staff the task of sending routine notices for minor infractions, i.e., for deficiencies that don't threaten the viability of a charter. (If that's the case, it's good to know where the authorizer draws that line.) Authorizers that have a decision-making body bound by open meetings laws, such as a school board or state charter commission, will usually take a vote to approve any serious intervention and will also vote to remove sanctions once the school has addressed the problem. Where there is no separate voting body and decisions are essentially made by staff, other provisions will be needed. The not-for-profit Volunteers of America, an authorizer in Minnesota, does not hold routine public meetings but does require that any intervention measures be included on the meeting agendas of charter school boards—and these must be posted on the school's own website.

RENEWAL AND REVOCATION POLICIES

Ideally, both a charter school and its authorizer can tell you from day one what it will take for that school's charter to be renewed and what shortcomings might merit revocation of the charter. Lenders should insist on clarity in these matters, especially if a renewal date is in sight.

Renewal

While authorizers may ask forward-looking questions in a renewal process (what will the school do differently in its next term?), the renewal decision itself reflects performance in the current term. This usually involves looking at indicators in the following areas:

- Academic performance
- Fiscal performance
- Governance effectiveness
- Leadership and instructional quality
- Compliance with the terms of its charter contract and applicable laws and regulations
- Mission fulfillment[17]

Renewal guidelines should tell with some specificity how performance in each of these areas is measured; how good it must be for the school to win renewal (or conversely, how bad it must be for the school to merit non-renewal); how the various elements are weighted in any overall calculation; and whether some elements are critical to the outcome. By the time of renewal, the authorizer should have a record of the school's performance in each area—a task made much easier if the authorizer gathers these elements within an overall performance framework.

It should be noted that whatever the school's ostensible record, due diligence performed during the renewal itself may reveal negative information. A site visit, for example, may uncover some serious lapse in compliance or classroom conditions that must be remedied before the process can proceed. Alternatively, the school may be renewed but given a renewal contract of one year instead of five so the authorizer has another opportunity for a high-stakes review.

NACSA's 2014 survey shows that nearly all large authorizers (96 percent) have established, documented criteria for evaluating charter school renewals, and 90 percent have explicit revocation protocols. The few that lack these essentials may be newer authorizers or those that oversee just a few schools and lack a well-developed methodology. In these cases, a potential lender may get a casual or anecdotal reading about a particular school's renewal chances. It may take some probing to see exactly how the decision makers are approaching their decision.

Finally, state policies can have a strong impact on whether charter schools get renewed. Most state charter laws provide an appeal process if a school wants to contest a closure decision. And NACSA supports what are known as "default closure" laws, which require that charter schools close if they chronically fall below an acceptable level of performance. Such laws should give authorizers the opportunity to make a case for renewal if there are extenuating circumstances. For example, if the school serves students who have dropped out and typically do not perform well on state tests, it may well merit renewal despite falling below state testing benchmarks.

Revocation

State charter laws usually spell out in stern terms the circumstances that allow an authorizer to move for charter revocation: material breach of the charter, financial misdealings, or imperiling the safety and welfare of students. These terms are usually repeated in charter contracts and may be amplified by more specific examples or interpretations of the statutory language.

In meetings of the Working Group, lenders made repeated reference to charter closures that caught them unawares—and said that their inquiries to authorizers hadn't disclosed looming problems. From a lender's perspective, closing a school it has funded can cause millions in losses for reasons that seem either political or simply opaque.

There are several potential explanations when charter schools are shut down in short order:

1. **The situation is quick moving and serious, and the authorizer has to take action.** It's important to remember that an authorizer's first duty is to the well being of students and the protection of the public interest. Even with audits, reporting, and site visits, a low-lying condition may suddenly flare into crisis, ignited by a whistle-blowing employee or a criminal investigation. Authorizers don't enjoy closing schools. They avoid doing so in mid-year if possible. But sometimes they must. When that happens, they should make efforts to communicate clearly with stakeholders and the public about the grounds for the decision.

2. **Lenders may not be asking the right questions.** It's not enough to ask, "How are they doing?" and "Are they OK for renewal?" Nor is it sufficient to try to find out whether an authorizer is "friendly." Lenders should ask specifically for the school's status with respect to each of the documents and processes mentioned above—while also collecting all the information commonly available, such as audits, test scores, and compliance history.

3. **Authorizers may lack needed capacity.** Some authorizers are unclear about their own standards for renewal and revocation (for example, a policy that spells out what happens to a school that earns a "D" on state rankings each year). Others lack the fully developed oversight systems described here. In either case, they may not be able to provide crisp answers to inquiries about their schools' prospects.

4. **Responsibility is diffused.** When authorizing offices are part of a state agency or district central office, day-to-day oversight responsibilities may be dispersed among several offices. But lenders need information on demand, so it's important that authorizers have a clear process for aggregating oversight findings and making decisions. The charter office should be in a position to speak with an authoritative voice about the status of its schools.

5. **There is ambiguity about what can and must be shared.** Lenders in the Working Group repeatedly complained about the difficulty of prying information from some authorizers. The complicated question of transparency is discussed next.

Transparency: How Is Charter Data Public?

Transparency is an essential building block for maintaining public confidence about accountability, whether in government, business, or the not-for-profit sector. Authorizers and lenders rely on an open flow of reliable information in order to make their decisions. Yet in their respective domains, both operate within certain boundaries.

Lenders have confidentiality rules that constrain the type of information they are able to share with any party other than their borrower. Banks are heavily restricted in the extent to which they are able to assist their clients with financial advice. CDFIs are less subject to such strictures.

But lenders who took part in Working Group discussions expressed frustration about getting needed information from authorizers. Some reported having to file Freedom of Information Act (FOIA) requests for data that should be readily available, such as audited financials and periodic authorizer reports.

As state-sanctioned institutions overseeing public schools, authorizers are subject to FOIA requests and must comply according to state timelines. In recent years—not just in charter matters but also across public agencies—it has become more difficult to shield information. Even some kind of "deliberative" documents (such as reviewer comments on charter applications) are likely to be disclosable.

Here are some suggested ground rules for the sharing of information:

SCHOOLS

» Schools themselves should be able to provide lenders with most documents that describe their financial health and organizational performance. These include their own annual reports; audits (including management letters); their track record of performance against existing loan covenants; and enrollment records and waiting-list information.

» If a school is unable or unwilling to provide these, the lender should proceed with caution—even if they can obtain the information from an authorizer.

AUTHORIZERS

» Authorizers, for their part, should have clear public information policies that delineate which reports, audits, and other information should be made readily available.

» Even if certain documents are legally subject to disclosure, authorizers should not be expected to produce information that has no actual bearing on a school's viability, for example, reviewer comments on the school's original charter application; raw notes from a staff member's school visit; and email or phone contacts between the authorizer and the school.

LENDERS

» Lenders should expect to receive from authorizers, upon request, documents that describe the school's status (in appropriately summarized form) and that may contribute to authorizer decisions about its charter. A suggested set includes the following documents:

- Annual reports produced by the authorizer on each of its schools; these should include summaries of school performance against targets in performance framework indicators.
- Audits (including management letters)
- Financial reports the school sends on a periodic basis to the authorizer
- Records of the school's legal and regulatory compliance, usually compiled by the authorizer on an annual basis
- Notices of intervention (including probation notices) and their resolution
- Completed site visit reports (as delivered to the school)
- The renewal criteria and any evidence affecting renewal prospects

Bottom Line: Can We Speak the Same Language?

Lenders seek to originate loans and investments that generate solid risk-adjusted returns and help schools meet their financial goals. Authorizers seek to develop portfolios of quality schools for the jurisdictions they serve. Both look for sound financial management; both have an interest in seeing that schools operate in buildings that are suitable to the needs of their academic programs and that are not financially burdensome. Even if there are differences in emphasis, they both need timely, reliable information to make their respective decisions.

Given their common interests, authorizers and lenders might even be able to create protocols for common data gathering. The following table suggests that despite different emphasis in use and interpretation, both groups look at similar bodies of information.

TABLE 2: **Operational, Financial, and Academic Data Useful to Lenders and Authorizers**

Data Type	Use to Authorizers	Use to Lenders
Enrollment by Grade, Annual and Planned	Compliance with charter, parent demand, basis of per-pupil funding, and key element of annual audit	Useful in underwriting top-line per-pupil revenue (from authorizing and/or funding agency) for a school; also useful in understanding whether a school is trying to grow too quickly (by projecting unrealistic growth in enrollment)
Student Applications / Wait List Count	Measure of parent demand and viability	Proxy for estimating demand for student seats (i.e., useful for estimating how difficult it would be to replace a student who left school)
Test Scores	Key indicator of academic performance, ideally combining absolute measures of proficiency with student-based measures of growth over time. Most charter contracts adopt state targets; they may include others set by authorizer.	For high-performing schools, does the school show consistent trends in test score data for all grades and sub-groups? How do test results compare to those of peer groups? For low-performing schools, does the school show signs of improvement in its academic performance? The goal is to understand proficiency, growth, and other markers of progress (when taking into account the starting points of students and student groups).
Organizational Chart	Included in charter application; only consulted if major changes made	May provide clues on management quality—"span of control" issues
Student / Teacher Ratio	Important only if spelled out in charter; not a normative issue	Proxy for extent to which there may be overcrowding of classrooms

Data Type	Use to Authorizers	Use to Lenders
Board Terms, Succession Plans	Stability of leadership; continuity in skill sets and representation of stakeholders	Stability of leadership
Teacher Certification	Compliance issue (where required)	Compliance issue
Teacher Retention	Sign of sustainability, but significance depends on context	Sign of sustainability
Liquidity (i.e., number of days or months of operating expenses held in cash)	Key measure of short-term financial viability, but authorizer standards may vary	Measure of how easily a school could weather a financial storm if its expenses were to unexpectedly spike
Leverage Ratio (i.e., total debt to total net assets)	Same as lender	Measure of the school or CMO's financial obligations relative to its overall size
Debt Service Coverage Ratio (i.e., [revenue minus expenses net of interest and depreciation] / total debt service)	Same as lender	Quantifies a school's ability to service its mortgage and other debt obligations
Personnel and Occupancy Expense Measurements	Similar to lender, but without common standards of measurement	What percentage of total revenue does personnel expense equal? What about occupancy expense as a percentage of total revenue? Underwriters often see 50-65% for personnel and 10-25% for occupancy expense.
Transparency Indicators (open meetings, board votes on major contracts, rules on conflicts, etc.)	Quality of governance	Quality of governance
Business Service Providers	School option, not overseen by authorizer	Possible indicator of operational quality

Looking Ahead

The opportunities for better communication and collaboration between charter school authorizers and lenders are significant. For that reason, the NACSA/LISC Authorizer/Lender Working Group has sought to further a productive conversation between the sectors.

Despite their differing purposes, both authorizers and lenders share significant common ground. Both have vested interests in the success and sustainability of the schools they support. Whether looking at charters to evaluate a potential loan or for purposes of public accountability, both want to see strong, high-quality schools that earn this sustainability by doing a great job of educating students and being able stewards of public money and public trust.

By working toward a better understanding of the other and how each evaluates charter schools, authorizers and lenders can enhance communication and begin to explore where collaboration may make sense.

Appendix I

NACSA/LISC AUTHORIZER/LENDER WORKING GROUP

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Appendix II

GLOSSARY

Community Development Financial Institution: "Community Development Financial Institutions (CDFIs) are specialized, mission-driven financial institutions that create economic opportunity for individuals and small businesses, quality affordable housing, and essential community services throughout the U.S. Four types of institutions are included in the definition of a CDFI: Community Development Banks, Community Development Credit Unions, Community Development Loan Funds (most of which are non-profit), and Community Development Venture Capital Funds. Some, but not all, CDFIs are certified by the CDFI Fund. Certification is often necessary in order to receive support from the CDFI Fund."[18]

Community Reinvestment Act: "The Community Reinvestment Act is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound operations. It was enacted by the Congress in 1977…and requires that each depository institution's record in helping meet the credit needs of its entire community be evaluated by the appropriate Federal financial supervisory agency periodically…A bank's CRA performance record is taken into account in considering an institution's application for deposit facilities."[19]

Debt Service Coverage Ratio: Net income available for debt service divided by debt service as projected for the latest year.[20]

Lender Liability: "US legal doctrine under which a lending bank may be held liable for a borrower's financial losses that are directly or indirectly related to the bank's actions. A bank is potentially liable for (1) loans made in bad faith, (2) refusing to advance new loans or credit extensions after promising to do so, (3) taking a controlling interest in the borrower's business, or (4) foreclosing on borrower's assets without proper procedure and notification."[21]

Loan-to-Value Ratio: "LTV is calculated by dividing the loan amount by the market value of the property securing the loan plus the amount of any readily marketable collateral and other acceptable collateral that secures the loan."[22]

Net Operating Income: Total revenues less total expenses (not including non-cash items [e.g., depreciation] and debt service) for a given time period.

New Markets Tax Credits: "The New Markets Tax Credit (NMTC) Program provides a tax incentive for private sector investment into economic development projects and businesses located in low-income communities. The program is overseen by the United States Department of the Treasury and is directly administered by the Community Development Financial Institutions (CDFI) Fund…The NMTC provides a subsidy that helps banks participate in projects in low-income communities that might not otherwise be eligible for financing. Bank investors receive a credit against federal income taxes for making qualified equity investments in CDEs [Community Development Entities]. The credit totals 39 percent of the cost of the investment and is claimed over a seven-year period."[23]

Program Related Investments: Provided by foundations and other donors, Program Related Investments (PRIs) are different from grants in that they are "low cost loans, loan guarantees, and equity investments to support a charitable project or activity. Because PRIs are paid back, the funds are recycled to further [the donor's] charitable purpose."[24]

Issuer: State or local government entity that has the power to authorize and issue bonds for not-for-profit organizations (including charter schools).[25]

Underwriter: Initial purchaser of the bonds from the issuer (via a bond purchase agreement), the underwriting firm will sell the bonds to municipal bond funds and other buyers of charter school bonds. The underwriter acts as an intermediary and does not intend to hold the bonds long term. Underwriters prepare the transaction's official statement or disclosure document, which is distributed to potential investors.[26]

U.S. Department of Education Credit Enhancement Program: "In 2001, Congress appropriated $25 million for a pilot credit enhancement program, the Charter School Facilities Financing Demonstration Grant Program. Its successor, the Credit Enhancement for Charter School Facilities Program (CE Program), was authorized under the No Child Left Behind Act and since 2003 has received annual funding ranging from $8 million to $37 million. Designed to stimulate private-sector financing for charter schools, the CE Program provides grant funds on a competitive basis to public and nonprofit entities to develop innovative credit enhancement models that leverage capital from the private sector. Program funds may not be used for the direct purchase, lease, renovation, or construction of facilities; they may be employed only to attract other financing for such purposes."[27]

Working Capital Line of Credit: Short-term loan facility (typically less than one-year term) made available to a charter school to cover cash flow shortfalls (e.g., borrowing to pay for a large one-time expense prior to receipt of quarterly per-pupil revenue).

Appendix III

TERM SHEET ITEMS

capital for healthy
families & communities

CHARTER SCHOOL FINANCING

The Low Income Investment Fund (LIIF) is a nonprofit community development financial institution (CDFI) dedicated to serving low income people and communities. At the core of LIIF's work is a commitment to alleviating poverty and helping families attain economic self-sufficiency. LIIF supports charter school projects located in distressed communities that provide education alternatives to low and moderate income students.

The terms below reflect the types of loan terms (but is not an all-inclusive list) that are likely to be found on a term sheet issued by a lender to a potential charter school borrower. Term sheets are typically project-specific, with the result that terms will vary based on the lender, type of loan requested, the specific project to be financed, the charter school's size, financial strength, operating history, and other factors.

Eligible Borrowers:	For-profit or non-profit 501(c)(3) organizations and single asset entities controlled by mission driven for-profit or nonprofit organizations
Purpose:	Funds may be used for acquisition, construction and mini-permanent financing and may cover the site acquisition, construction, closing costs and capitalized interest reserve if necessary.
Product Type:	Acquisition, Construction, Mini-Perm and Permanent direct loans, as well as New Markets Tax Credit transactions
Loan Size:	Loan sizes range from $2 – 20 million depending on financing product and project specifics
Loan Fees:	Origination fees are 1% to 2% depending on loan size. Borrower will also be responsible for all legal and third party report and documentation fees incurred as part of the loan approval and closing process.
Loan Term:	Acquisition: Up to 3 years; Mini-Perm: Up to 7 years Construction: Up to 18 months; Permanent Loan: Up to 29.5 years New Market Tax Credit: 7 years
Interest Rate:	Priced at affordable rates based on the transaction structure. Please call LIIF to inquire about current interest rates.
Repayment:	Interest only or amortizing depending on structure. While source of repayment need not be committed at funding, the proposed repayment source at maturity will be analyzed.
Collateral:	Loans are generally secured by real estate in a first priority position. LIIF may consider a junior position and/or additional collateral depending on the strength of the project and the cumulative loan-to-value. Loans are recourse to project sponsors and guarantees may be required.
Loan-to-Value:	Maximum LTV from 80-90% depending on the financing product and project specifics.

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