STATE POLICY SNAPSHOT:

FACILITIES FINANCING FOR PUBLIC CHARTER SCHOOLS

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The National Alliance for Public Charter Schools is releasing the third report in a series of State Policy Snapshots for Public Charter School Facilities. The first two reports, State Policy Snapshot: School District Facilities and Charter Public Schools in September 2016 and State Policy Snapshot: Facilities Funding for Public Charter Schools in July 2019 address the critical issues of accessing facilities and securing funding for facilities. This third report addresses the issue of financing the facility.

This document looks at credit enhancement policies that states are utilizing to help charter schools achieve more favorable financing conditions for their acquisitions. Credit enhancement describes a variety of measures taken to enhance the strength of a school's underlying credit in the eyes of investors. This results in more favorable financing terms when charter schools are acquiring, constructing, and/or renovating facilities. While the federal Credit Enhancement for Charter Schools Facilities Program is widely known in the charter school community, there is significantly less information about the state programs. The purpose of this paper is to provide the charter school community and policy makers with a more complete picture of the credit enhancement that may be available to charter schools.

In addition to better financing terms, credit enhancement programs can improve a charter school's ability to obtain financing in the first place. Whether it concerns private loans or tax-exempt bonds, credit enhancement provides added reassurance to the lender that the charter school borrower will meet its repayment obligations. Credit enhancement can take the form of additional collateral, insurance, or payment guarantees, each reducing the risk of default in the lender's eyes and resulting in reduced interest for the charter school borrower. Even small interest rate changes can produce significant savings over the life of a school's debt service. These savings can be used for teaching and learning rather than paying interest costs.

State credit enhancement programs can provide effective, low-cost financing support for charter schools seeking to reduce costs for facilities financing, significantly reducing tax-payer dollars spent on facility debt service.

For the purposes of this paper, state credit enhancement programs have been categorized into three main categories:

- **State Bond Credit Enhancement** is a guarantee by the state that if a charter school defaults on a bond payment, the state will make a payment on behalf of the charter school. This is often accomplished by the state funding a debt service reserve account. If the charter school draws on the debt service reserve account, it must pay back the state to replenish the debt service reserve fund.

- **State Loan Credit Enhancement** is a guarantee by the state that if a charter school defaults on a loan payment (sometimes including lease payments), the state will make a payment on behalf of the charter school. If the charter school draws on the credit enhancement, it must pay back the state.

- **Moral Obligation enhancement** is where the executive branch of a state or municipality promises or pledges to seek a legislative appropriation to replenish a debt service reserve fund that has been drawn upon to meet debt service payments to bondholders in the event a borrower is unable to make its scheduled payments. Under a moral obligation clause, the appropriators (i.e., legislators) are not required to make the requested appropriation. Notwithstanding that caveat, the moral obligation pledge effectively substitutes the credit strength of the state or municipality (which can be far superior) for that of the charter school, resulting in significant interest savings for lower-rated borrowers.

For more information on charter school and moral obligation programs, please visit https://facilitycenter.publiccharters.org/resource/moral-obligation to review state laws and research papers.

Most of these credit enhancement programs are funded by the state. A few of them received their funding from the U.S. Department of Education's Charter School Program (CSP). The CSP has an annual Credit Enhancement grant competition to award funding to be used for credit enhancements for charter schools. This award competition is open to nonprofits, charter school operators, and state entities. The state programs that are funded by federal CSP grants are noted in the table below and the Appendix.

This document provides a snapshot of the 12 jurisdictions that have credit enhancement programs that are statutorily-created, statutorily-funded, and/or enacted in their state.

Credit Enhancement programs across the states:

- One state (Texas) provides a permanent fund for bond issuances for charter schools.

- One state (Arizona) provides a guarantee for bond issuances for charter schools.

- Two states (Arkansas and Michigan) provide a credit enhancement fund for bonds for charter schools.

- Five states have a credit enhancement fund for loans for charter schools. The California, D.C., Idaho, and Massachusetts programs are funded; Ohio's is not.

- Four states provide a Moral Obligation Bond credit enhancement. The Colorado, Idaho, and Utah programs are active; Indiana's is not.

State-by-state details about state laws can be found in the Appendix.

LANDSCAPE OF CREDIT ENHANCEMENT BY STATE

STATE	BOND ENHANCEMENT FUND	MORAL OBLIGATION BOND ENHANCEMENT FUND	LOAN ENHANCEMENT FUND
Arizona	State Funded		
Arkansas	State Funded		
California			Federal CSP Funded
Colorado		Active	
District of Columbia			State Funded, Federal CSP Funded
Idaho		Active	State Funded
Indiana		Inactive	
Massachusetts			Federal CSP Funded
Michigan	Federal CSP Funded		
Ohio			Unfunded
Texas	State Funded, Federal CSP Funded		
Utah		Active	

APPENDIX: STATE-BY-STATE CHARTER SCHOOL FACILITIES CREDIT ENHANCEMENT POLICIES

STATE	PROVISIONS
Arizona	**State Bond Enhancement** The Arizona Credit Enhancement Board (CEB) guarantees the full principal and interest payments on a charter school's bonds. Eligibility for the CEB program is based on the school's state academic performance rating rather than on a third-party credit rating; to be eligible, a school must have an "A" academic rating. Funded at $100 million, the program came online in 2017 and as of November 2019 has unlocked $213 million in funding for charter school building projects. For schools that participate, bonds carry the rating of the CEB program (currently "AA-"). Though the program is technically open to all public schools, as of November 2019, it has only been used by charter schools. Citations: Ariz. Rev. Stat. Ann. § 15-2151 to 15-2158 AZ Office of Education Credit Enhancement Program
Arkansas	**State Bond Enhancement** Charter schools eligible for tax-exempt bond financing through the Arkansas Development Finance Authority (ADFA) are also eligible to apply for its bond guaranty program, which was initially established to support nonprofits but expanded to include charter schools. ADFA has established a Bond Guaranty Reserve Account to meet amortization payments in the event that a borrower is unable to make such payments in accordance with the bond indenture. ADFA has guaranteed financing for three charter schools for a total of $16.135 million in facilities bonds, of which $15 million is currently outstanding. ADFA's Bond Guaranty Reserve Account has reached its upper limit, with $75 million in bonds outstanding. Citation: Ark. Code Ann. § 15-5-401 et seq.
California	**Federal CSP-Funded Enhancement** California law directs the state treasurer's office to provide a limited credit enhancement program, administered by the California School Finance Authority (CSFA) through its Charter School Facilities Credit Enhancement Grant Program. CSFA has leveraged federal funding from an FY 2010 $8.3 million award, and subsequently an FY 2017 $8 million award and an FY 2019 $20 million award, from the Charter School Facilities Credit Enhancement Grant Program to fund the primary debt service reserve requirement for debt issued by or through CSFA for a charter school to acquire, renovate, or construct charter school facilities. Citations: 4 CA ADC § 10192 to 10199
Colorado	**State Moral Obligation** Since 2002, Colorado has offered Moral Obligation financing for qualified charter school borrowers, issuing debt through the Colorado Educational and Cultural Facility Authority (CECFA). Under the program, the state agrees to ask for a legislative appropriation to make debt service payments in the event a charter school borrower defaults on its bond payments. The legislation includes a debt service reserve fund (as of February 28, 2017, the fund had a balance of $4.7 million) that may be tapped to cover a school's default prior to asking for a legislative appropriation. To qualify, schools must be given an investment grade rating by one of the national bond rating agencies and be approved by the State Treasurer. As of December 31, 2018, the outstanding par value of the bonds issued under the moral obligation program was $400.9 million, of the $500 million authorized. Over the lifetime of this program, CECFA estimates participating schools have saved more than $100 million in interest payments. Citations: Colo. Rev. Stat. Ann. § 22-30.5-404 to 408 CECFA: Funding for Charter Schools CO Department of Treasury Charter School Intercept and Moral Obligation

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District of Columbia	**State Loan Enhancement** Federal law and D.C. Code provide for a Credit Enhancement Revolving Fund, which provides credit enhancement to eligible public charter schools for the purchase, construction, and/or renovation of school facilities. The program offers guarantees or collateral pledges of up to $1 million for up to five years. Since inception, the Credit Enhancement Program has provided more than $32.5 million of support to 38 public charter schools, leveraging more than $354.4 million in additional funding for school facilities. Citations: Authorized by 20 U.S.C. 1155(e)(3)(C)(iii), approved in accordance with D.C. Code §2-301.05a DC OSSE: Credit Enhancement for District of Columbia Public Charter Schools DC OSSE: Facilities Financing for DC Public Charter Schools **Federal CSP-Funded Enhancement** In 2004, the D.C. government received a $5,088,242 grant award from the U.S. Department of Education, which was then transferred to the Office of the State Superintendent of Education (OSSE) in 2007. This grant supports the Charter School Incubator Initiative, which began as a collaboration between Building Hope and OSSE and has since grown into its own entity called Building Pathways. Once charter schools are ready to move on from the initial incubator space, Building Pathways provides a combination of services to assist them with finding and obtaining a long-term facility, including credit enhancement. Since 2006, these federal funds and the Charter School Incubator Initiative have helped 26 charter schools. Citation: Summary of the District of Columbia Charter School Facility Law Charter School Facility Incubators Report
Idaho	**State Loan Enhancement** Idaho law creates the Public Charter School Debt Reserve to assist qualifying charter schools in obtaining favorable financing for facility improvements and construction. A public charter school seeking to use the public charter school debt reserve must be financed through the Idaho Housing and Finance Association, and their overall facility costs cannot exceed 20 percent of their revenues. A charter school can seek to use this fund to guarantee up to 24 months of principal and interest payments, at a fee equal to 10 basis points of the principal. In 2016, the state allocated $750,000 to this fund. Citation: Idaho Code Ann. § 33-5217 **State Moral Obligation** Modeled after Colorado's and Utah's programs, the Idaho Public Charter Schools Facilities Program provides moral obligation from the state as a credit enhancement mechanism for facilities projects of charter schools that have maintained good academic, financial, and operational standing for at least three years and that deposit 12 months of bond payments in a restricted debt service reserve fund (DSRF) that, pursuant to the moral obligation pledge, would be replenished through state appropriation if drawn upon and not replenished through other sources. To lessen the likelihood of the need for appropriation, the program is structured with a backstop reserve fund that could be employed to replenish the DSRF. Schools are required to deposit at bond closing a one-time fee equal to 0.5% of the issue paramount and an ongoing annual fee equal to 0.075% (7.5 basis points) on the bond's outstanding principal balance. Moral obligation bonds are generally rated one notch lower than the state's general obligation bonds. With Idaho's AA+/Aa1 rating from S&P and Moody's, respectively, these moral obligation bonds will have ratings significantly higher than the schools could achieve on their own credit strength. Idaho's program became law in 2019 and has not yet been used. Citation: Idaho Code Ann. § 33-5218

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Indiana	**Moral Obligation** Early on, Indiana statutorily allowed use of the State of Indiana's and the City of Indianapolis' Moral Obligation pledge for charter schools; however, the statute has not been actively implemented on behalf of the state's charter schools, and the program is no longer funded. In 2002, the Indiana Legislature (House Bill 1108) authorized charter schools in Indianapolis to obtain financing through the Indianapolis Local Public Improvement Bond Bank, and all other charter schools to obtain financing through the Indiana Bond Bank. This legislation also provided the moral obligation pledge of the city or state, respectively, through the preexisting reserve fund (backed by state appropriations) that supports debt issued through these authorities. Citations: IC 5-1.4-1-10; IC 5-1.4-5-1 Education Commission of the States: Indiana State Profile
Massachusetts	**Federal CSP-Funded Enhancement** In Massachusetts, charter schools may access tax-exempt bond financing, direct loan financing, and guarantees for capital projects through the Massachusetts Development Finance Agency (MassDevelopment), a quasi-public state authority responsible for economic development lending. MassDevelopment created the Massachusetts Charter School Loan Guarantee Fund in partnership with, and supported by, the Massachusetts Charter Public School Association, the Massachusetts Department of Elementary and Secondary Education's Charter School Office, the Boston Foundation, and the Local Initiatives Support Corporation (LISC) to guarantee up to $3 million per school on debt for the acquisition, construction, renovation, and leasehold improvement of charter school facilities. MassDevelopment noted that there have been certain cases where they have been able to go up to $5 million per school due to the high property prices in Massachusetts. MassDevelopment has been awarded a total of $32 million in federal Charter School Facilities Credit Enhancement Grant Program awards since 2003. As of March 2019, the fund has closed 47 transactions on behalf of 34 charter schools, providing $68.6 million in credit enhancement that has leveraged $400.1 million. Citations: MassDevelopment Loans & Guarantees
Michigan	**Federal CSP-Funded Enhancement** The Michigan Finance Authority (MFA) Conduit Financing & Credit Enhancement Program provides tax-exempt financing and technical assistance for qualified public educational facilities and public school academies (PSAs, Michigan's name for charter schools). In 2007, the MFA (then known as the Michigan Public Educational Facilities Authority (MPEFA) prior to Executive Order No. 2010-02, which consolidated multiple public finance authorities into a single entity) received $6.5 million through a federal Charter School Facilities Credit Enhancement Grant Program award to fund debt service reserves for bond issuances, thereby lowering borrowing costs for participating charter schools. While the entire $6.5 million federal grant has been expended, the funds are expected to be recycled as they are repaid to MFA. As of July 2017, the former MPEFA and MFA have collectively issued more than $275 million in bond financing for 32 PSAs. Citation: USED Implementation of the Credit Enhancement for Charter School Facilities Program Report **State Moral Obligation** Michigan law prohibits the state from pledging its moral obligation for charter school facility financing. Citation: Mich. Comp. Law Ann. §388.1618c

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Ohio	**State Loan Enhancement Program** In 2001, the Ohio legislature created the Community Schools Facilities Guaranteed Loan Fund to guarantee loans to charter schools to construct, acquire, improve, or replace school buildings and classroom facilities. The program would enable the Ohio Facilities Construction Commission to take on an aggregate liability of up to $10 million to guarantee for up to 15 years up to 85% of the sum of the principal and interest on a loan made to the governing authority of a community school (Ohio's name for charter schools). The state has yet to provide funding for this program. Citations: Ohio Rev. Code Ann. § 3318.50; § 3318.52
Texas	**State Bond Enhancement Program** In 1854, the Texas legislature designated $2 million for the establishment of the Permanent School Fund (PSF) to help finance public schools. The Texas Constitution of 1876 set aside the sale proceeds from half of Texas' remaining public lands to be designated to the PSF. In 1983, a constitutional amendment for the PSF was approved to guarantee bonds issued by school districts. In 2011, the Texas legislature authorized the Charter District Bond Guarantee Program as a new component of the PSF Guarantee Program to allow open-enrollment charter schools with investment grade ratings to apply to the Commissioner of Education for designation as a charter district, thus enabling eligibility to have their bonds guaranteed by the PSF. In 2013, the Texas legislature specified that charter school districts could also apply to refinance debt through the PSF bond guarantee program. Note: bond financing of facilities for school district-operated charter schools is subject to the School District Bond Guarantee Program, not the Charter District Bond Guarantee Program. Bonds backed by the PSF are rated at the very highest triple-A level from all three major rating agencies. The PSF is authorized to guarantee bonds up to three times the value of the reserves. While the PSF's value is constantly changing, as of August 31, 2013, the end of PSF's fiscal year, its remaining guaranty capacity for all schools was more than $17 billion. Texas charter school districts may access PSF guarantee capacity in proportion to the number of school children enrolled in charter schools. Based on an earlier proportion of charter school students, approximately 4%, it is expected that up to $1 billion of the PSF's capacity may be used to back charter school bonds. Guarantee by the PSF may favor a charter school bond by as much as 400 basis points. Citations: Texas Educ. Code Ann. § 7.102(c)(33); § 12.135; § 45.051 et seq.; § 45.063; 19 Texas Administrative Code §33.67 Commissioner's Rules on the Charter Reserve Fund TEA: The Permanent School Fund Guarantee Program **Federal CSP-Funded Enhancement** In 2006, a consortium of Texas entities including the Texas Public Finance Authority Charter School Finance Corporation (CSFC), the Resource Center for Charter Schools which was replaced by the Texas Charter Schools Association (TCSA) in 2009, and the Texas Education Agency (TEA) was awarded a $10 million federal grant. The money was used to create the Texas Credit Enhancement Program (TCEP), a guarantee fund for tax-exempt revenue bonds, to finance the acquisition, construction, repair, renovation, or refinancing of charter school facilities. There are no credit rating requirements for this credit enhancement program, unlike the Permanent School Fund, however, there are requirements for academic and financial accountability ratings. Citation: TX Const. Article 5 § d & e; Texas Educ. Code Ann. § 45.301; § 53.351; § 11.1542 thru 1543 Texas Credit Enhancement Program Application

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Utah	**State Moral Obligation** In 2012, Utah law created the Charter School Credit Enhancement Program to assist qualified charter schools in obtaining favorable financing by providing the state's moral obligation and providing a means of replenishing a qualifying charter school's debt service reserve fund. The state appropriated $3 million to this program in FY 2013. Citations: Utah Code Ann. § 53G-5-601 Utah Charter School Finance Authority: Credit Enhancement Program LISC 2014 Charter School Facility Finance Landscape Report

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