

Public Charter Schools Borrowing with Tax-Exempt Bonds

FOURTH EDITION



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DISCLAIMER: NOTHING CONTAINED IN THIS BOOKLET SHOULD BE CONSTRUED OR RELIED UPON AS LEGAL ADVICE. INSTEAD, THIS BOOKLET IS INTENDED TO SERVE AS AN INTRODUCTION TO THE GENERAL SUBJECT OF THE USE OF TAX-EXEMPT BONDS BY CHARTER SCHOOLS, FROM WHICH BETTER INFORMED REQUESTS FOR ADVICE, LEGAL AND FINANCIAL, CAN BE FORMULATED.

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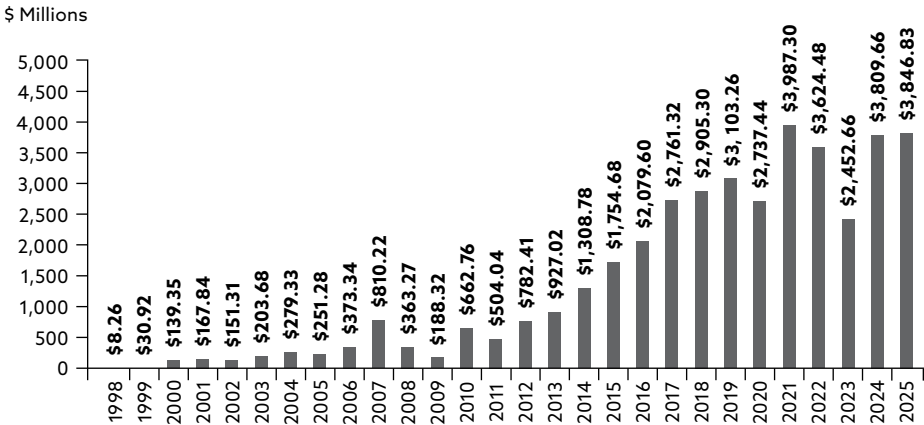
CHAPTER 1

Introduction

Over three decades into the public charter school movement, securing affordable educational facilities remains a persistent challenge nationwide. Numerous enterprises have evolved as solutions to this affordability crisis, including government-sponsored, private sector, and collaborative programs that provide facilities, financing, or both. Among these, the issuance of tax-exempt bonds remains an effective option to obtain relatively low-cost facilities financing.

Nonprofit corporations and governmental entities have borrowed money using tax-exempt bonds for decades. While major hospitals and universities once dominated the marketplace of nonprofit borrowing, individual public charter schools and groups of commonly managed public charter schools are now regularly borrowing on a tax-exempt basis. Since 1998, public charter schools have borrowed over \$40 billion using tax-exempt bonds.¹

For illustrative purposes, the par amount of tax-exempt debt issued each year between 1998 and 2025 is shown below:



Source: Siebert Williams Shank & Co., LLC

¹ See "Charter School Bond Issuance: A Complete History Volume 4" (2023) published by the Charter School Advisors and the Local Initiatives Support Corporation, available at report.lisc.org/charter-school-bond-study/national-perspective.

Bond market access has been spurred by increasing demand for facilities, better understanding of the benefits of tax-exempt financing, and greater market acceptance of public charter school credits. Not only large, established public charter school management organizations (CMOs) with substantial financial resources need apply, but also relatively small, even start-up, public charter schools with limited credit history may be financeable under certain circumstances.

The main purpose of this booklet is to provide public charter schools and their stakeholders with relevant information about the benefits of tax-exempt financing, including:

- Who qualifies for tax-exempt financing
- What types of projects qualify for tax-exempt financing
- How to decide if tax-exempt financing might be right for your school
- Some insights, based on years of experience, about best practices and what to expect from financing participants and the overall process

The booklet starts by asking the basic question, “Why use tax-exempt bonds?” From there, attorneys from the leading bond counsel firm in the country² will explore the nuts and bolts of uses of proceeds, structuring considerations, including considerations of ownership versus leasing of facilities, financing for networks, market disclosure, bond investor insights, financing milestones, and what to expect after the bonds are issued and the project is underway.

² Rankings for securities transactions of various types are performed annually by Securities Data Company, which has ranked Orrick number one in the country as bond counsel for tax-exempt bonds nearly every year for over 20 years. On average, Orrick handles more than 300 bond issues as bond counsel, aggregating more than \$16 billion, each year.

CHAPTER 2

Why Use Tax-Exempt Bonds?

To fund their capital project needs, public charter schools generally have the following choices:

- Conventional taxable financing from a bank or similar private loan
- Charitable contributions or other accumulated funds
- Governmental financing (grant or loan) programs
- Federal tax-credit and community development financial institution (CDFI) financing
- Equitable Facilities Fund and other philanthropic lenders
- Tax-exempt financing by private placement or publicly offered bonds

Of these, tax-exempt bond financing is often the best option because it offers the lowest cost-of-borrowing, greater flexibility and usually the best terms. While each public charter school's specific circumstances are unique, and may make other options more advantageous, tax-exempt bonds should always be included in the analysis of facilities financing options. This chapter compares tax-exempt bonds with the five other major alternative methods of funding capital projects.

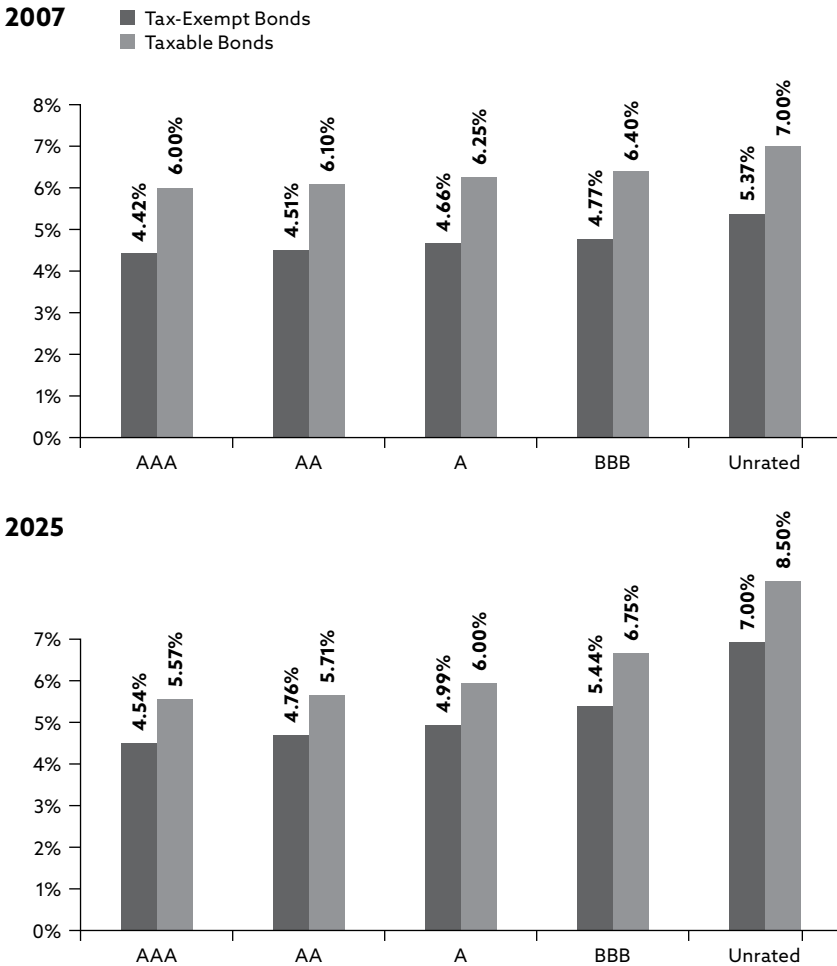
A. COMPARISON TO TAXABLE DEBT

Interest Rates. The public capital markets where tax-exempt bonds are traded typically offer lower interest rates than private loans or bank financing for the simple reason that more competition usually produces lower rates.¹ Tax-exempt financing typically offers lower interest rates than taxable debt

¹ A brief explanation of this dynamic involves simple economic supply/demand rules. A commercial bank loan typically involves one lender, who has great leverage over the borrower in negotiating the terms of the loan. A private placement of a bond issue or note issue similarly involves one or a very limited number of private investors, who again, enjoy leverage in negotiations because no one else is competing for the opportunity to buy the bond or note (i.e., to provide the loan). In a public offering, bonds are offered for sale to the entire marketplace of municipal bond investors. This creates competition (greater demand) for the right to purchase the bonds, and thus shifts some of the leverage in negotiating financing terms (depending on a variety of credit factors) back toward the borrower. For discussion of other factors affecting borrowing cost, see Chapter 6 "Credit Considerations", and Chapter 7 "Investor Perspectives".

because the interest is exempt from federal, and often state, income tax. The investor/lender requires a lower interest rate to produce an equivalent after-tax return on comparable taxable debt.

For example, interest rates on 30-year bonds with various credit ratings² sold around July 1, 2007, and around July 1, 2025, were roughly as follows:



Source: Siebert Williams Shank & Co., LLC

² Ratings refer to independent appraisals of the credit quality of the bonds and the likelihood of their repayment performed by one or more of the credit rating agencies: Standard & Poor's Financial Services LLC, Moody's Investors Service or Fitch Ratings, Inc. The ratings are expressed as letter grades AAA, AA, A, BBB (expressed as Aaa, Aa, A and Baa by Moody's) from highest to lowest investment-grade ratings, with +/- or numerical subcategories. Ratings are considered very important by the underwriters in marketing the bonds and by investors in determining what interest rates will induce them to purchase the bonds. Charter school bonds are often sold without a rating, although usually at higher interest rates. See Chapter 6 "Credit Considerations", and Chapter 7 "Investor Perspectives", for more information.

While the difference, referred to as the “spread,” between taxable and tax-exempt rates fluctuates over time, the fundamental lower cost of tax-exempt debt remains constant.³

Tenure. Tax-exempt debt is often issued on a long-term basis of 20 to 35 years, and at fixed interest rates. On the other hand, most taxable debt is often issued with a shorter term and on the basis of variable interest rates indexed to the prime lending rate, U.S. Treasury notes or bonds, or SOFR.⁴

Short- or medium-term taxable debt generally matures earlier than the useful life of the financed facility and has to be extended or refinanced, exposing the school to refinancing risk and causing the school to expend new resources both in money and in time when it comes time to refinance shorter term financings. Market conditions, interest rates, and bank lending policies have historically fluctuated, and in some cases dictate higher interest costs to refinance or worse, the inability to refinance. Tax-exempt debt, on the other hand, generally aligns the term of the financing with the usefulness of the project, which adds predictability to school budgeting and planning over the life of the financed facility and can extend the time horizon for refinancing options.

Size of Borrowing. The tax-exempt bond market usually accepts financing of 100% of a project’s cost, in contrast to a typical bank or traditional loan financing, which may be limited to 70–75% of the value of the asset financed.

The financial covenants required in connection with tax-exempt and taxable financing are typically similar. Both types of financing limit the ability of the borrower to incur additional debt or encumber property, specify levels of liquid assets or asset to liability ratios, put conditions on the acquisition or disposition of property and on mergers or consolidations, and require quarterly or other regular reporting. In cases of failure to meet these covenants, conventional lenders usually reserve the right to intervene directly in the school’s operations or to liquidate collateral assets. Tax-exempt financing remedies typically allow for a cure period during which time the school works with an independent consultant to restore debt performance or other covenant compliance. While foreclosure on a tax-exempt bond financed facility is a remedy under the terms of most financings, it is a remedy of last

³ The comparison between taxable and tax-exempt bond interest rates is for illustrative purposes only, and it should be noted that charter schools rarely, if ever, finance facilities entirely using taxable municipal bonds.

⁴ SOFR is a broad measure of the cost of borrowing cash overnight collateralized by U.S. Treasury securities, published daily by the Federal Reserve Bank of New York, and has become the predominant U.S. dollar benchmark interest rate for floating-rate debt. SOFR replaced the London Interbank Offered Rate (LIBOR), which for decades served as the primary global benchmark reflecting the average rate at which major banks were willing to lend to one another on an unsecured basis, but which was permanently discontinued in 2023 following findings of manipulation and a decline in the underlying interbank lending market.

resort. As discussed further in Chapter 14 “Post-Issuance Compliance”, tax-exempt financing also requires the school to covenant to comply with certain restrictions designed to ensure that interest on the related bonds remains tax-exempt for the life of the financing.

In summary, tax-exempt financing typically offers better interest rates, longer-term financing and more flexible terms and conditions compared to conventional taxable financing.

B. COMPARISON TO AVAILABLE FUNDS AND CONTRIBUTIONS

The availability of tax-exempt financing presents one of those rare circumstances in which it may be better to borrow than to pay with accumulated or donated funds, even if there are ample available funds. While public charter schools do not generally maintain substantial cash reserves or endowment funds, an increasing number of schools and CMOs have been able to grow substantial cash reserves to guard against financial uncertainties or in supporting long-term capital programs.

Accumulated funds of nonprofit corporations can normally be invested in taxable obligations earning taxable rates of return on which the nonprofit corporation does not, however, pay any tax. On the other hand, because rates applicable to tax-exempt borrowing are based on market rates for tax-exempt obligations, the interest is not subject to income tax in the hand of the investor/lender. This can provide investors with the same after-tax returns as taxable obligations, but at lower interest rates. As a result, by spending proceeds of tax-exempt debt on facilities instead of accumulated funds, a public charter school may have the opportunity to invest those accumulated funds in taxable obligations yielding more than it must pay in interest on the tax-exempt debt. This earnings advantage on the accumulated funds can serve as additional operating cash or as a capital reserve for the school and help to demonstrate financial strength to potential investors.

For example, imagine a CMO wishes to finance a \$20 million project and has \$20 million of available funds. If the \$20 million is invested at 7%, and the CMO can also borrow with tax-exempt bonds at 5.5%, the CMO will earn \$350,000 a year more on its investments than it is paying on the bonds. Of course, there will be some costs associated with issuance of the bonds, which will depend on the size and difficulty of the financing, but except for relatively small financings of \$5 million or less, such costs are usually less than one year’s worth of this earnings advantage.

While reinvestment yields after the Great Recession rendered this type of earnings advantage significantly more difficult to achieve, nonprofit corporations have realized this type of earnings advantage in more recent years as interest rates trend upward. This earnings advantage, based on the spread between taxable and tax-exempt interest rates, is referred to as "arbitrage." As discussed further in Chapter 5 "Interplay Between Bonds and Fund-Raising", federal tax requirements for the tax exemption of interest on bonds govern when such arbitrage is permitted.

Thus, although it is somewhat counterintuitive, available funds may be better held and invested while using tax-exempt borrowing to finance facilities.

C. COMPARISON TO GOVERNMENTAL FINANCING PROGRAMS

Over 25 states have developed public charter school facilities financing programs to address the dire need in the marketplace.⁵ Such programs offer facilities financing at no cost through grants or at very low interest rates through a variety of loan or guarantee programs. By necessity of public policy, these programs tend to involve a variety of eligibility requirements, competitive access, lengthy and sometimes costly procurement procedures, public bidding rules, and rigorous ongoing compliance provisions. Many programs also mandate governmental ownership of the financed facilities. By comparison, public charter schools that use tax-exempt bonds retain ownership of the financed facilities and thereby exercise control over the design and future use of such facilities. Ownership of the facility may also give the school the opportunity to leverage the asset for future renovations or other expansion plans. Further, tax-exempt bond financings generally impose fewer restrictions on things like site location and design as compared with governmental grant or loan programs.

Governmental grant and loan programs may also involve significantly greater periods of time to access funding. As described in more detail in Chapter 12 "Steps to Issuing the Bonds and the Finance Team", a typical bond financing schedule ranges from 90–120 days absent unexpected complications. A governmental grant or loan program, however, may involve a year or more from application to receipt of funds. Moreover, governmental funding may be subject to budgetary constraints on apportionments or to other problems affecting the funding source, independent of the applicant's eligibility.

⁵ See "How Are Charter Schools Funded" published on October 30, 2025 by the Charter School Facility Center, available at data.publiccharters.org/knowledge-base/4-how-are-charter-schools-funded.

The only limitation on the size of a public charter school's borrowing with tax-exempt bonds is the school's ability to pay. If a public charter school can meet the debt service obligation, a project generally can be fully funded (that is, 100% debt-financed) with tax-exempt bonds. By contrast, regardless of a public charter school's ability to pay, few governmental charter facilities financing programs provide all of the funding needed to cover the cost of a project. Those that do may be in high demand and only accessible through a competitive process. Instead, many programs provide partial funding to spread resources among a greater number of public charter school projects, giving rise to a shortfall and the need for multiple sources of funding to complete a single project.

Thus, while a federal or state agency or local chartering authority may be able to offer comparable or even zero-cost funds relative to tax-exempt financing, the need for capital has to be balanced with program requirements, limitations, timing and other restrictions.

D. COMPARISON TO FEDERAL TAX-CREDIT FINANCING AND COMMUNITY DEVELOPMENT FINANCIAL INSTITUTION (CDFI) FINANCING

Federal tax law establishes the exemption from federal income tax on interest earned on municipal bonds, including those issued on behalf of nonprofit corporations such as public charter schools, thereby incentivizing the flow of private capital to public infrastructure financing. The tax code also encourages public infrastructure development by providing tax credits to lenders or investors who lend or purchase and hold bonds issued through qualifying programs to finance certain types of public capital improvements, such as affordable housing and in certain locations, such as qualified low-income communities. Tax-credit financing has been used successfully for public charter school facilities located in qualified areas or serving qualified populations of students, providing a relatively low cost-of-capital similar to tax-exempt bonds.⁶ In addition, the U.S. Treasury Department designates certain lending institutions that serve low-income individuals or distressed or underserved communities as "CDFIs" which enables access to a variety of federal grants, tax credit and bond guaranty programs.

⁶ For a discussion of examples of tax-credit financing for charter school facilities, see "Charter School Facilities Finance: How CDFIs Created the Market, and How to Stimulate Future Growth" by Annie Donovan, a working paper published in 2008 by the Center for Community Development Investments in the Community Affairs Department of the Federal Reserve Bank of San Francisco, available at frbsf.org/publications/community/wpapers/2008/wp08-02.pdf; see also, "2014 Charter School Facility Finance Landscape" published in September 2014 by The Educational Facilities Financing Center of the Local Initiatives Support Corporation, available at lisc.org/our-initiatives/education/charter-school-financing/publications/charter-school-facility-finance-landscape.

The successful completion of both tax-exempt bond financings and tax-credit loan or CDFI financings relies on the assembly of a team of knowledgeable professionals who have experience in the marketplace. In either case, nuanced legal negotiations and structuring decisions must be coordinated with market conditions and investor or lender appetite to secure the most favorable financing.

Key differences between tax-credit and tax-exempt financing include the following:

- **Location of facilities.** While existing tax-credit financing programs require the school to be located in a qualified geographic area,⁷ there are no restrictions on the geographic location of a school financed with tax-exempt bonds.
- **Availability of funding.** Generally, there is no statutory limit on the dollar amount of tax-exempt bonds that may be issued in a given year by a given municipal conduit issuer on behalf of any individual public charter school or all public charter schools. Tax-credit loans and related bonds are dependent on the availability of tax credits, as determined by Congress on a periodic basis for the nation as a whole. A public charter school must apply for and receive the right to use tax credits, if available. Once the allotment of tax credits in a given year has been allocated to various tax-credit loans or bonds in a given tax-credit financing program, no further financings may be completed through such program unless and until Congress provides for a new allotment of tax credits.
- **Term of loan subsidy.** Tax-exempt bonds for public charter schools are typically structured as long-term financings (20–35 years), and the tax-exemption of interest is designed to remain in effect for the life of the bonds assuming the school adheres to the terms of the financing. However, existing tax-credit financing programs provide a maximum of seven years subsidy⁸ to the school, regardless of whether loan amortization is longer. Generally, at the end of a tax credit subsidy

⁷ The New Markets Tax Credit (NMTC) program rules require charter schools to be located in qualified low-income communities. Certain exceptions also apply, regarding low-population density and high-migration patterns. See the NMTC rules at [cdfifund.gov/programs-training/Programs/new-markets-tax-credit/Pages/default.aspx](https://www.cdfifund.gov/programs-training/Programs/new-markets-tax-credit/Pages/default.aspx).

⁸ The most frequently utilized tax-credit program is the New Markets Tax Credit program described above in footnote #7, which has a seven year tax-credit subsidy period. Longer tax-credit subsidy periods apply to both Qualified Zone Academy Bonds and Qualified School Construction Bonds, each with subsidy periods ranging from 14–19 years (reset daily by the U.S. Department of Treasury). The authority for the QZAB program was repealed by the Tax Cuts and Jobs Act after December 31, 2017, and the QSCB program was limited to tax-credit volume cap allocated in 2009 and 2010 under the federal Recovery Act. As of publication, neither program has been renewed.

period i.e., when investors have recognized or used all the tax credits, the public charter school bears an increase in the cost of its debt or must refinance the debt to maintain affordability. Tax-exempt bond financing may be available to refinance a tax credit financing at the end of the subsidy period, depending on market conditions. (See Chapter 4 “Eligible Uses of Bond Funds”, regarding refinancing rules.)

Key differences between CDFI and tax-exempt financing include the following:

- **Population served by financed facilities.** While CDFI lenders are limited in providing financing to schools serving low-income or distressed communities, there are no restrictions on the demographic characteristics of the students of a school financed with tax-exempt bonds.
- **Terms of loans.** Tax-exempt bonds for public charter schools are typically structured as long-term financings (20–35 years), and the tax-exemption of interest is designed to remain in effect for the life of the bonds assuming the school adheres to the terms of the financing. CDFIs offer a variety of financing products, which range from short-term interest-only bullet maturity structures (where all principal is due at maturity in a lump sum) to fully amortizing long-term loans under the CDFI Bond Guarantee Program.⁹ CDFIs may be organized as either nonprofit organizations or for-profit organizations, and generally those that are organized as nonprofits offer more competitive financing terms and lower interest rates. CDFI loan terms are generally similar to commercial bank loans, including the requirement for a minimum amount of borrower equity (which may be satisfied through CDFI grants, subordinate debt or other means of assistance) and taxable-equivalent loan interest rates. Tax-exempt bond financing may be available to refinance a CDFI financing at maturity, depending on market conditions. (See Chapter 4 “Eligible Uses of Bond Funds”, regarding refinancing rules.)

⁹ See information on the Bond Guarantee Program at cdfifund.gov/programs-training/programs/cdfi-bond.

E. COMPARISON TO EQUITABLE FACILITIES FUND AND OTHER PHILANTHROPIC FUNDS

As discussed in more detail in Chapter 16, Equitable Facilities Fund (EFF) is a nonprofit organization established in 2017 that offers long-term facilities financing to public charter schools across the United States. EFF uses credit enhancement to lower borrowing costs for public charter schools through a revolving loan fund model. Using philanthropic contributions, EFF began making loans to public charter schools at rates designed to be lower than the public charter schools would otherwise be able to obtain on an unenhanced basis.

Over time, as EFF has made multiple loans to schools using these philanthropic resources, it has pooled the loan repayments from multiple public charter school borrowers as security for its own tax-exempt bond financing. The credit strength of EFF's tax-exempt bonds is greater than the credit strength of any individual public charter school loan in its revolving loan fund, allowing EFF to borrow at lower rates, and continue making additional loans to public charter schools on the same basis.

Thus, a loan from EFF is an indirect mechanism for a public charter school to access the tax-exempt bond market, and in most cases to do so on more favorable terms than it would be able to obtain on its own. As a result, the limitations on uses of loan proceeds and the post-closing compliance rules that apply to tax-exempt bond financings, as outlined in Chapters 4, 13 and 14, also apply to borrowers in the EFF loan program. The key differences between a typical tax-exempt bond issuance by a public charter school and a loan from EFF are as follows:

- **Lower interest rate:** as described above, EFF's loan program is designed to provide the borrower with a loan interest rate that reflects EFF's lower cost of borrowing in the tax-exempt bond market, saving the borrower on annual interest payments as compared to a stand-alone bond market financing;
- **Lower transaction costs:** EFF generally makes loans directly to the borrower (either the public charter school or an affiliate), in a two-party transaction. Compared to the multiple parties described in Chapter 12 required to complete a tax-exempt bond financing for a public charter school, fewer involved parties translates to fewer consultant and legal fees, which generally results in lower overall transaction costs.

- **No reserve fund:** as described in Chapter 4, one of the common uses of bond proceeds for a public charter school is the funding of approximately one year’s debt service into a trust account that remains available for the life of the bonds to cover any missed payments. In a typical EFF loan transaction, such a reserve fund is not required, resulting in a lower overall borrowing amount (avoiding the need to borrow to fund the reserve fund), which lowers the overall repayment burden.

Taken together, the benefits of an EFF loan generally make such loans more advantageous to public charter schools as compared to undertaking a stand-alone tax-exempt bond financing. However, as noted above, the public capital markets have demonstrated the historical capacity to provide upwards of \$4 billion to eligible public charter schools each year. EFF’s lending capacity is far more limited, averaging about 10% of the facilities financing need for public charter schools each year. In addition, EFF’s lending criteria are stringent, placing significant weight on the academic outcomes of students in the school and prioritizing schools that serve underserved communities and student populations. To preserve optionality and adhere to a well-defined facilities strategy or timeline (acquisition or new construction), public charter schools often parallel track the analysis of the efficacy of a bond financing while simultaneously applying for an EFF loan.

A number of other philanthropic facilities financing funds have been established since the founding of EFF, including those providing short-term loans, construction loans, loans to early stage schools or “year zero” schools, bridge loans to more permanent financing and targeted geographic funds designed to support the growth of the public charter school sector in a particular city or region.¹⁰ Each employs a version of the EFF revolving fund model seed funded with philanthropic contributions, and each offers benefits associated with philanthropic support and nonprofit mission-alignment. Comparison of each to bond financing is beyond the scope of this booklet, but borrowers should carefully examine the particular options available for their projects to determine the ideal financing solution.

¹⁰ See, for example, Facilities Investment Fund, fiflending.org; Level Field Facilities Fund, levelfieldfacilitiesfund.org; Building Hope Facilities Fund, buildinghope.org; Catapult Fund by 22 Beacon, 22beacon.org; Dell Catalyst Fund by the Charter School Growth Fund and EFF, dell.org; and Blueprint Fund by Blueprint, blueprintfutures.org/financing; as well as regional philanthropic-based funds such as the Tennessee Facilities Fund, Texas Facilities Fund, Heartland Facilities Fund, DC Facilities Fund (Washington, D.C.) and Nevada Facilities Fund.

CHAPTER 3

Timing of Project Acquisition

The acquisition of public charter school facilities financed with tax-exempt bonds may take one of three basic paths:

1. purchasing a site and undertaking a new construction project;
2. purchasing an existing facility and undertaking renovations to convert it to the school's intended use; or
3. purchasing a completed facility, that has been built or renovated to the school's specifications, and is ready for occupation and use.

The choice of whether to acquire the facility before or after the period of time during which the facility is still under construction or major rehabilitation (the "construction period") influences the structure of the tax-exempt bond financing. Depending upon the approach taken, there are at least two options for structuring the tax-exempt bond financing:

- (a) acquisition and construction financing undertaken separately from the tax-exempt financing of the permanent loan, or
- (b) tax-exempt financing that covers both the acquisition and construction and permanent loan.

In the former approach, tax-exempt bonds are only needed for the permanent financing.

A. SEPARATE CONSTRUCTION AND PERMANENT FINANCING

The inherent economic problem associated with the construction period (which may last from one to three years) is how to pay the debt service for a loan associated with a new facility for which there are no operating revenues, while continuing to pay occupancy expenses for the existing facility in which the school operates. In essence, during the construction period, the school could be obligated to pay double for its facilities; once for the current space and again for the space under construction.

Generally, tax-exempt financing is not practical or cost effective for short-term construction period loans. Instead, schools may utilize lending institutions that specialize in providing construction loans to public charter schools. These institutions are experienced in managing construction risk and bring expertise in project finance, management, and construction to help ensure timely and effective project completion. These short-term loans are predicated on the availability of long-term (or “permanent”) financing to repay (or “take out”) the short-term loan. They are typically structured to mature in a lump sum (“bullet”) upon project completion, with no payments (or only interest payments) due in the interim. When choosing this path, the school will follow the steps outlined in Chapter 12, “Steps to Issuing the Bonds and the Finance Team,” during construction. This process culminates in the issuance of bonds on or around the maturity date of the short-term loan, which will coincide with the completion of the project.

B. COMBINED CONSTRUCTION AND PERMANENT FINANCING

A tax-exempt bond financing can be (and is often) structured to cover both construction financing and permanent financing. The economic problem of simultaneously paying for two facilities is typically solved by financing the debt service obligation of the public charter school during the construction period. In other words, the loan is structured such that principal does not begin to amortize until after scheduled construction completion, and interest payments are made from the proceeds of the loan itself (known as “capitalized interest”) during the same period (and often for a short additional contingency period).¹ However, timely and successful project completion remains of paramount concern.

Because completion of the project is a prerequisite to the public charter school’s occupancy and use, the construction financing risk in this case is shifted to the tax-exempt bond investors. Delays in or failure of completion could result in the school being obligated to repay the bond debt service while it continues to pay the occupancy expense for its existing facilities, and potentially the costs created by an extended construction period. Extra precautions are taken in this approach to ensure timely and on-budget project completion. Since investors are taking both construction risk and permanent financing risk, they will expect that charter schools have detailed disclosure

¹ Federal tax rules generally permit proceeds of tax-exempt bonds to be used for this purpose for up to three years after issuance of the bonds. See Chapter 4 “Eligible Uses of Bond Funds”, for more detail.

regarding the project plans, the construction or project manager, the general contractor, and the terms of a guaranteed maximum price construction contract, in addition to the ordinary disclosure about the school's finances and operations.² This approach is more suitable for schools that have substantial internal expertise (either at the staff or board level) in project finance and management, or that have access to such expertise through a CMO, consultants, financial advisors, or attorneys.

C. ACQUIRING A COMPLETED FACILITY

The public charter school facilities development landscape includes a number of private, nonprofit and for-profit real estate development organizations specializing in the construction and renovation of facilities for public charter schools.³ These developers arrange their own financing (or otherwise arrange access to capital) for site acquisition and construction or renovation of the project, while working closely with the school to design the facility and establish a timeline for completion. This arrangement may be particularly beneficial because, in addition to its own financing, the developer brings valuable expertise in local real estate markets, public charter school architectural design, general contracting and construction, procurement, and project management (little of which exists within a typical school's staff or board of directors). Certain developers may even be able to facilitate the school's arrangements for permanent financing through tax-exempt bonds.

Some contracts provide that the developer lease the new facility to the public charter school for a number of years at a negotiated rate. This arrangement can prove beneficial when lease costs are set at affordable rates, allowing the school to focus on programmatic success and enrollment stabilization before the process of obtaining permanent financing is required.

In this approach, the school follows the steps outlined in Chapter 12 "Steps to Issuing the Bonds and the Finance Team", either during the construction period or near the end of the lease term, culminating in the issuance of bonds on or around the completion of the project or lease termination. The proceeds of the bond issue are primarily used to finance the purchase of the completed project from the developer (at a price at least sufficient to cover

² See Chapter 10 "Market Disclosure", for more explanation of the charter school's information disclosure obligations in connection with a tax-exempt bond issue.

³ Four prominent examples of nonprofit developers include Blueprint (formerly Pacific Charter School Development) (see blueprintfutures.org), Civic Builders (see civicbuilders.org), 22 Beacon (formerly Charter Schools Development Center) (see 22beacon.org) and Building Hope (see buildinghope.org).

the developer's original acquisition cost and construction costs). This option solves the inherent economic problem of paying for two facilities, as the school does not pay for the construction financing. Instead, the developer has borne this cost. The school easily transitions from paying for its existing facility to paying the debt service on its new facility upon the closing of the bond financing.

CHAPTER 4

Eligible Uses of Bond Funds

There are five eligible categories of expenditures of the proceeds of tax-exempt debt:

(1) capital expenditures, (2) refinancing prior debt, (3) reimbursing prior capital expenditures, (4) working capital, and (5) financing costs, such as costs of issuing the bonds, capitalized interest and reserves. A single bond issue may combine more than one or even all of these purposes. In addition, proceeds of tax-exempt bonds may be invested during the period prior to their expenditure for the above-mentioned purposes, creating an opportunity for permissible arbitrage earnings.

A. CAPITAL EXPENDITURE PROJECTS

The most common use of any debt is the acquisition or construction of a project, land, buildings, equipment and/or related infrastructure. The primary limitation on the types of projects that can be financed with tax-exempt bonds is that they must be owned by the nonprofit corporation (public charter school or CMO) or by a governmental entity. Such projects may not be used (i) in a manner that constitutes an unrelated trade or business under Section 513(a) of the Internal Revenue Code (which generally means that it be used in a manner consistent with the nonprofit purpose of the corporation) or (ii) in the trade or business of another person or entity (other than another 501(c)(3) corporation or governmental entity) (a "non-exempt person").

B. REFINANCING PRIOR DEBT

Refinancing outstanding taxable debt, including construction financing, tax-credit financing, bank loans and mortgages, is a very common use of tax-exempt bonds, particularly (but by no means exclusively) by first-time users of tax-exempt debt. The primary limitation is that the proceeds of the prior debt were used for capital projects that would have qualified for original financing with tax-exempt bonds as described above in subsection A.

Tax-exempt bonds may also be used to refinance (or “refund”) prior outstanding tax-exempt bonds, although so-called “advance refunding” of outstanding tax-exempt bonds are not permitted on a tax-exempt basis as of January 1, 2018, as a result of the 2017 Tax Cuts and Jobs Act. An advance refunding occurs when the issuance of the refunding bonds is more than 90 days before repayment of the tax-exempt bonds to be refunded. In an advance refunding, proceeds of the new bonds are invested in a special trust (or “escrow”) fund until the date of repayment of the prior bonds. Refundings of tax-exempt bonds within 90 days of repayment of the refunded bonds remain available, and the provisions of the 2017 Tax Cuts and Jobs Act do not prohibit refinancing of taxable debt, as described in the preceding paragraph.

C. REIMBURSING PRIOR CAPITAL EXPENDITURES

Under certain circumstances, capital expenditures that could qualify for financing with tax-exempt bonds, but which are made prior to issuance of the bonds, can be reimbursed with proceeds of the bonds when issued.

The tax rules generally prohibit reimbursement of expenditures made prior to the issuance of bonds based on a concern about where to draw the line. However, there are some exceptions:

1. If the prior expenditures were made with the proceeds of a bank loan or other type of borrowing which is still outstanding, then that prior debt may be refinanced, as described in the immediately preceding section (B).
2. Certain preliminary “soft costs” such as architectural, engineering, surveying, soil testing and similar costs paid prior to commencement of acquisition, construction or rehabilitation of a project may be reimbursed in an amount up to 20% of the aggregate issue price of the bonds issued to finance the project. Land acquisition, site preparation and similar costs are not included in such “soft costs.”
3. Any other capital expenditures (including costs of issuance) paid before the bonds are issued may be reimbursed if they are paid after, or not more than 60 days before, the public charter school expresses “official intent” to reimburse such expenditures by resolution, declaration or other action that meets the requirements of applicable tax regulations. Certain limitations apply, namely that the reimbursement can only be made no later than 18 months after the later of (a) the date the cost is paid or (b) the date the project is placed in service (but in no event, more than

three years after the cost is paid). One of the first steps in any serious consideration of a tax-exempt financing for a capital project should be the adoption of an official intent reimbursement resolution. Properly drafted, it can be simple and nonbinding. There is no cost or liability to not issuing the bonds or not using the proceeds for reimbursement. Bond counsel will normally provide such a resolution upon request without charge. (See Chapter 12 "Steps to Issuing the Bonds and the Finance Team", below.)

Bond proceeds used to reimburse the public charter school as described in (1) or (2) above are considered "spent" and may generally be used for any purpose or invested at an arbitrage profit by the nonprofit corporation without regard to the restrictions otherwise attached to tax-exempt bond proceeds. (See section (F) below regarding investment of bond proceeds.)

D. OPERATING FUNDS (OR "WORKING CAPITAL")

While use of tax-exempt bonds to finance operating expenses (or "working capital") is not specifically prohibited, the tax rules governing the tax-exemption of interest on the bonds make such financings impractical. This holds true, except in some cases for an amount not exceeding 5% of the bond proceeds (net of reserves), if used as working capital in connection with the project being financed with the balance of the bond issue.¹

E. COSTS OF ISSUANCE, CAPITALIZED INTEREST, RESERVES

Costs of Issuance. Costs incurred in connection with issuing the bonds, such as underwriter's discount or fees, fees of bond counsel and other lawyers and consultants, rating agency fees, trustee's fees and the like, may be included in the bond issue, subject to a cap of 2% of the tax-exempt bond issue, which cap does not include the cost of any bond insurance or credit enhancement. While this 2% cap may be sufficient to cover costs of issuance, as a bond issue size decreases, issuance costs tend to remain constant. Therefore, for a relatively small issue size (\$5 million or less) additional sources of financing may be required (in excess of the 2% cap). In this case, a taxable series of bonds can be added to the financing sized to cover exactly the amount

¹ Programs have been developed to assist charter schools with cash management, by providing temporary funding of operating costs (for example, to bridge gaps in the receipt of state funding). Orrick attorneys involved with such cash flow management programs in certain states can provide more information. See the contact information on the inside back cover of this booklet to locate a member of Orrick's Charter School Finance Group for more information.

beyond the 2% cap and structured to mature first (since the debt will bear a higher taxable rate of interest).

Capitalized Interest. Interest payable on the bonds during the longer of three years or the period in which the project is to be constructed and for up to one year after completion of construction, may be included (i.e., capitalized) in the bond issue. The capitalized interest is used to pay interest on the bonds, with the result that the public charter school does not have to pay any debt service on the bonds from its own funds during such period.

Reserves. A debt service reserve fund is used to pay debt service on the bonds, if for any reason the public charter school fails to pay. The debt service reserve fund is solely for the protection of investors and is expected to be used only as a last resort. It is common to have a debt service reserve fund held by a trustee bank on behalf of the bondholders, and funded with bond proceeds equal to the lesser of 10% of the bond issue, 125% of average annual debt service on the bonds, or (in the typical case) maximum annual debt service. Other reserves, such as operating reserves, may also be funded with bond proceeds but usually only within the limitations on working capital set forth in section (D) above.

F. INVESTMENT OF PROCEEDS

The proceeds of tax-exempt bonds, regardless of how they will ultimately be applied, will be held by a trustee bank and should be invested from the date of issuance until such time as they are spent. The earnings on such investments are always taken into account in structuring the tax-exempt financing, and under certain conditions these investments give rise to permissible arbitrage opportunities. The scale of this earnings advantage is dependent on the characteristics of the financing plan and market conditions at the time of bond issuance.

The key controlling metric in structuring the investment of tax-exempt bond proceeds is the bond "yield." Yield can be thought of broadly, as the overall interest cost to the public charter school of its tax-exempt borrowing. More specifically, yield refers to the discount rate which, when used in computing the present value of all unconditionally payable payments representing principal, interest and certain other costs paid and to be paid with respect to the bonds, produces an amount equal to the issue price of the bonds.

The yield is determined at the time of issuance of the bonds and functions as a ceiling for certain investment earnings purposes. For instance, proceeds of tax-exempt bonds issued to fund acquisition or construction of capital projects (as in section (A) above) may, so long as certain conditions are met, be invested without regard to the yield on the bonds, creating the opportunity to earn arbitrage and apply those earnings to pay project costs.

During the fifth year after issuance of tax-exempt bonds, the public charter school will be required to file a return with the IRS, declaring any arbitrage earnings associated with the bonds. Based on the applicable tax rules, if the school has earned too much arbitrage, then certain amounts may be required to be returned (or "rebated") to the IRS. The complex rebate rules generally follow the policy premise that the federal subsidy created by the income tax exemption on the school's bonds is limited, and any excess subsidy garnered through disallowed arbitrage earnings must be returned to taxpayers. Thus, careful investment planning in consultation with qualified tax counsel is vital to a properly structured tax-exempt financing that maximizes arbitrage earnings and minimizes rebate liability. See Chapter 12 "Steps to Issuing the Bonds and the Finance Team", and Chapter 14 "Post-Issuance Compliance", for more information about rebate analysis and compliance.

CHAPTER 5

Interplay Between Bonds and Fund-Raising

While most public charter schools operate exclusively on the funding provided through state per-pupil funding formulas, some larger, more established schools or large networks of commonly managed schools may have a choice of financial resources to apply to a facilities project, including:

1. proceeds of tax-exempt bonds,
2. donations and pledges,
3. quasi-endowment or other accumulated funds, or
4. third-party guarantees or other financial support, perhaps from a foundation with which the school has close ties.

As pointed out above in Chapter 2 “Why Use Tax-Exempt Bonds?”, to the extent that tax-exempt bond proceeds can be used instead of other funds that can be invested in taxable obligations, it is possible to earn more on the investments than the interest paid on the bonds. Again, this earnings advantage, based on the spread between tax-exempt and taxable interest rates, is referred to as arbitrage.

As described in Chapter 4 “Eligible Uses of Bond Funds”, the federal tax requirements governing the tax-exemption of interest on bonds prohibit certain types of arbitrage. One type of arbitrage that is prohibited is that which results from using the proceeds of tax-exempt bonds to “replace” moneys that have been raised or set aside, and restricted or earmarked, specifically to finance the same project to which the tax-exempt bond proceeds would be applied.¹ However, so long as the donations were not restricted to use on acquiring or constructing the project, or other funds that may have been accumulated were not specifically and formally earmarked for the project, then the use of tax-exempt bonds instead of such donations or accumulated funds generally would be permissible. For this reason, it is

¹ The “replacement” issue occurs when the moneys raised or set aside for a project are freed up by the bond issue. No issue is presented to the extent that the project is financed with such moneys in combination with tax-exempt bond proceeds.

advisable to consult bond counsel as early as possible regarding these issues and any related fund-raising program. It is usually easier to raise funds for a project than for endowment, and bond counsel can offer advice about how to phrase fund-raising campaign literature and pledge documentation (including in some cases, how to recast pledges already received) in a manner designed not to interfere with the fund-raising objective yet concurrently preserving the maximum opportunity for tax-exempt financing and for permissible arbitrage.

In order to improve the security and possibly the ratings of the bonds (and thereby lower the interest rate), the public charter school may be asked to pledge a portion of any available reserve or other funds or to promise to maintain available fund balances at a particular level. If the pledge creates too great of an assurance that the pledged moneys will be available to pay debt service on the bonds (even if the school encounters financial difficulty), or if the fund balance required to be maintained exceeds the amount reasonable for the purpose for which it is maintained, or is tested more frequently than semi-annually, the nexus between such funds and the bonds may be considered so close that applicable tax regulations will require the yield on investments of such funds to be restricted to the yield on the bonds, thereby eliminating some of the benefit of tax-exempt bonds. It does not matter whether the pledge or covenant is to the bondholders or to a guarantor of the bonds. However, it is usually possible to structure a pledge or fund balance requirement in a manner that provides reasonable security without tripping over the yield restriction line.

Foundations, community development financial institutions, and other third parties may provide a variety of forms of financial support to a public charter school's project, such as cash contribution, collateral, or guaranty. The best structural choice to optimize the benefits of the tax-exempt financing will turn on similar issues to those discussed above, as well as on the particulars of any legal relationship between the third party and the school.

The proper allocation of the resources mentioned at the beginning of this chapter is an important part of the "art" of structuring a financing that maximizes the benefit of the tax-exemption of interest on the bonds and the potential arbitrage earnings advantage described above. In situations where these opportunities apply, this will be one of the most important steps in formulating the transaction.

Federal tax regulations relating to the measurement and tracking of private business use provide flexibility for public charter schools engaging in strategic

planning. Charter schools can benefit from these rules primarily by using tax-exempt bonds to finance a portion of the total cost of facilities and using other sources of funding to finance the remaining costs. "Qualified equity" is the term used for these other sources of funds and can include donations and pledges, accumulated revenues, or taxable debt. While limits apply to these other funding sources, they often can be applied in a fluid manner throughout the bond-financed project.

Assume a charter school plans to issue tax-exempt bonds and also use qualified equity to finance the simultaneous construction of two buildings on the same or separate campuses. If the charter school elects to treat both buildings as a single project, the qualified equity can be treated as and used to pay for any portion of the two buildings that, from time to time, has private business use. In fact, that allocation of qualified equity to private business use occurs automatically and shifts to the changing locations in the buildings where the private business use is occurring. It does not matter whether the qualified equity is spent first, last, or ratably. This type of "floating equity" allocation can be made to one or more assets so long as the assets are part of the same project. A project that includes multiple facilities acquired or constructed in the same time frame and financed with multiple sources of funds, including the proceeds of an issue of tax-exempt bonds, qualifies for this treatment. This allocation provides flexibility to the charter school by permitting (i) use of its facilities by private entities when they are not being used by the charter school and (ii) use by the charter school for unrelated trade or business activities. However, the charter school is limited on such use and the revenues therefrom by federal tax law restricting the scope of unrelated trade or business activities that may be conducted by a 501(c)(3) organization.

While the circumstances are too varied and the applicable tax rules often too complex and subtle to cover more thoroughly here, advice of highly qualified bond counsel with substantial experience in this area is needed and should be accessed at the earliest possible stage. (See Chapter 12 "Steps to Issuing the Bonds and the Finance Team", below.)

CHAPTER 6

Credit Considerations

When evaluating public charter school bonds, investors conduct a comprehensive credit analysis to determine whether the anticipated returns justify the investment risk. This assessment typically examines the school's operational stability, including the security of its charter authorization and renewal prospects along with its governance structure. Investors also evaluate competitive positioning within the geographic market, the experience and track record of the leadership team, and academic outcomes relative to peer institutions. In addition, investors closely review the terms of the contractual arrangement between the school and its bondholders, including security features, covenants, and ongoing disclosure obligations. Generally, a public charter school is viewed as more creditworthy the higher it ranks across these characteristics, and a transaction is considered more secure the greater the protections afforded to bondholders under the bond documents. Together, these factors directly influence the interest rates associated with the tax-exempt bonds.

Investors rely on a variety of sources of information in assessing the public charter school's creditworthiness or risk profile and in making their investment decisions. These may include (a) the school's audited financial statements and operating information, (b) academic performance data, including results on state or national assessments, graduation and retention rates, and any academic research and press coverage regarding the school, (c) information regarding the chartering authority, its legal framework, and relationship with the school, (d) assessments and evaluations by the chartering authority, if any, (e) physical inspection of the school site and operations, (f) the school's primary market disclosure and any continuing disclosure made available through EMMA, and (g) the analysis of third-party credit rating agencies, if applicable. Most of this information is already in existence when a public charter school begins the process of a bond financing, with the exception of the primary market disclosure (or "official statement") and the credit rating. At the time a transaction commences, counsel will work closely with the school to prepare the official statement,

which will ultimately be provided for investor review prior to the sale of the bonds. (See Chapter 10 “Market Disclosure”, for details about the official statement.) Additionally, if the school so elects, applications will be made to one or more credit rating agencies for review of the transaction and rendering of a credit rating.

A. RATING AGENCY CRITERIA

Credit rating agencies play an important role in tax-exempt bond financing, giving investors comfort that a standards-based third-party review of the risk profile of the public charter school and the proposed transaction has been undertaken. An “investment grade” credit rating is considered “BBB” or higher.¹ Three of the major municipal bond credit rating agencies, S&P, Moody’s, and Fitch, maintain published methodologies for evaluating charter school credit. Reading these varied approaches together provides charter school leadership with insight into what actions, policies, and environments can assist schools in accessing the bond market. S&P focuses on a two-pillar approach analyzing Enterprise and Financial Profiles to produce a stand-alone credit assessment. Moody’s uses a four-factor scorecard across the categories of Economy, Financial Performance, Institutional Framework, and Leverage. Fitch evaluates across three key rating drivers: Revenue Defensibility, Operating Risk, and Financial Profile, where the weakest element tends to carry greater weight. Of those three, S&P remains the most active in the sector, with a significantly larger charter school rating portfolio than Moody’s or Fitch.² Most unenhanced charter school ratings remain below investment grade, reflecting the relatively high leverage and limited operational and financial flexibility that characterize many charter schools. Since the first public charter school bond rating in 1999, about half of the total number of public charter school tax-exempt financings have been rated, with the trend increasing each year as the sector matures.³ While this area of credit analysis continues to evolve, some common analytical themes have emerged among the three agencies. Generally, to garner an investment-grade credit rating, schools must satisfy the following criteria (although each specific school’s circumstances will ultimately be determinative):

¹ For explanation of the credit rating scale, see Chapter 2 “Why Use Tax-Exempt Bonds?”, at footnote 4, therein.

² The three major credit rating agencies and their most recent charter school credit ratings publications, which are updated from time to time, are as follows: Fitch Ratings, see “U.S. Public Finance Charter School Rating Criteria”, November 10, 2025, available at [fitchratings.com](https://www.fitchratings.com); Standard & Poor’s, see “Credit Rating Model: Charter School Credit Scoring Model”, March 14, 2024, available at [spglobal.com](https://www.spglobal.com); and Moody’s Investors Service, see “Rating Methodology – US K-12 Public School Districts”, July 24, 2024, available at [moody.com](https://www.moody.com). (Note these websites may require registration.)

³ See “Charter School Bond Issuance: A Complete History Volume 4” as referenced in Chapter 2 “Why Use Tax-Exempt Bonds?”, at footnote 1, therein.

- 1. Authorizing Statutory Scheme.** Rating agencies generally assess the state authorizing framework by examining the clarity and fairness of the charter application and renewal process. Factors that typically support stronger credit assessments include longer charter terms, a demonstrated pattern of successful renewals, consistent and predictable per-pupil funding from the state, and a constructive relationship between the authorizer and the school. Under current Fitch criteria, the strongest Policy Framework assessments are reserved for schools with extended continuous operation (more than 25 years) and a history of multiple, timely charter renewals at the maximum allowable term. The specific relationship a school has with its chartering authority is also reviewed (a collaborative working relationship in which the authorizer does not compete with the school for students or funding is viewed favorably). The presence of procedural safeguards, such as advance notice of deficiencies and opportunities for corrective action before revocation, are also viewed favorably, as are provisions for appealing adverse decisions to alternative authorizing bodies.
- 2. Program and Market Position.** Rating agencies analyze a school's competitive position across several key dimensions. S&P assesses demand and competition within its market position factor, considering enrollment data and retention rates. Fitch places significant emphasis on Enrollment and Academics within its Revenue Defensibility assessment, evaluating waitlist depth relative to total enrollment capacity, geographic footprint, and overall enrollment scale based on multiple years of headcount and average daily attendance data. Moody's scores enrollment trends within its Economy factor, focusing on enrollment growth patterns over a multi-year period. A school's competitive position is generally considered stronger when its educational program addresses an unmet need within the local market, whether through specialized curricula (such as science and technology, arts, or career-focused programs), a distinctive instructional approach, or demonstrably superior academic outcomes. Evidence of sustained demand, such as enrollment at or near capacity supported by an active and verified waiting list, provides important corroboration of market appeal. Other factors include student retention rates between grades, teacher retention rates, growth trends in the school's enrollment area, student performance relative to competing programs on state or national standardized assessments, the program's reputation, and the school's relationship with parents and community constituents.

Finally, the prospect of future competition is also analyzed, including whether barriers to entry exist (such as limits on the number of charters that may be granted), whether the authorizer conducts robust market assessments before granting new charters, and whether competing schools could be established that may compromise enrollment at existing schools.

3. Management Team and Organizational Structure. The strongest public charter school management teams demonstrate broad organizational expertise, including programmatic, financial, managerial, operational, and legal capabilities, supported by an experienced and independent board with representation across education, business, legal, finance, government, and fund-raising backgrounds. Effective leadership is vital, but overdependence on a single founder or a small group of “visionary” leaders is viewed as a credit risk (sometimes referred to as “founder’s dilemma”); rating agencies look favorably on cross-training of key personnel, institutionalized policies and procedures, robust financial planning processes with clear and measurable targets tied to strategic goals, timely and complete financial reporting, and consistent performance within or above budgeted expectations. In order to borrow using tax-exempt bonds, the school must be organized as a nonprofit corporation exempt under Section 501(c)(3) of the Internal Revenue Code or be characterized as an instrumentality of the government. Both individual schools and larger charter management organizations (CMOs), or networks of commonly managed charter schools, may be eligible to borrow.⁴

In addition to the above factors, evaluation of the credit of CMOs typically involves a two-pronged analysis: first, an assessment of the entire system of commonly managed schools; and second, an assessment of that portion of the system that will be the source of repayment of the proposed bonds. Where bonds are secured by an obligated group, the rating agencies will generally analyze obligated-group financial and operating information, or on consolidated information where non-obligated components are de minimis and not impactful. CMOs can provide significant value in terms of the consistency in operating and financial management practices. However, if a CMO arrangement is challenging, it can divert management attention and resources and add reputational risks. The credit rating on

⁴ See Chapter 11 “Transaction Structure and Documentation”, for discussion of alternatives to the charter school being the borrower entity. Other affiliated nonprofits may also be eligible.

the bonds will generally be capped at the lower of the two prongs of the analysis. Thus, even if one school in a CMO network is far stronger on a stand-alone basis than the others, in a bond offering the rating will typically be limited by the credit profile of the obligated group or system, reflecting the expectation that CMOs will share resources across the system to assist a struggling school.

The credit analysis of a CMO's bond offering also takes into account the degree to which the school or schools that will be obligated to repay the bonds impact the overall operating health of the system. The more "core" to the system the financed schools are deemed, the more likely the bond rating of the financed schools can rise to match the overall rating of the system.

- 4. Financial Management and Operating History.** A minimum of three-to-five years of operating history, ideally including the successful completion of at least one charter renewal process, is generally viewed as the strongest scenario for an investment-grade credit rating; under Fitch's current criteria, schools with less than five years of operation are considered to have a limited operating record, although a highly experienced board and management team with a demonstrated track record at other charter school organizations may support a stronger assessment. Rating agencies place significant emphasis on financial management capabilities, recognizing that charter schools often operate with limited financial reserves and constrained revenue flexibility. Schools that demonstrate sound financial stewardship, evidenced by timely audited financials, effective internal controls, realistic budgeting practices, and consistent achievement of financial targets, are viewed more favorably in the credit analysis process.⁵ Important factors in this analysis include maintenance of operating reserves and liquidity, adherence to established reserve and investment policies over time, effective cash flow management, regular oversight and reporting (including timely continuing disclosure to EMMA), financial contingency planning for unexpected challenges, expenditure flexibility, and a consistent history of budget-to-actual performance.
- 5. Debt Management and Financial Planning.** Undertaking the construction or acquisition of a facility involves incurring significant debt relative to a public charter school's operating revenue, and

⁵ See Chapter 7 "Investor Perspectives", for discussion of charter school tax-exempt bond payment defaults.

the rating agencies' assessment of leverage and debt service capacity is a central element of the credit analysis. Rating agencies evaluate financial performance, liquidity and financial flexibility, and debt burden as components of their financial profile assessment. Dependence on future enrollment growth or future borrowings to meet debt service obligations is viewed as risky, and conservative, as data-driven projections are expected. Favorable factors include the availability of per-pupil state funding for facilities, appropriately sized projects (completion of the project with a single financing is preferred over phased financings that depend on subsequent capital raises), and disciplined capital maintenance practices that do not rely on future borrowing.

6. Bond Transaction Legal Provisions. Finally, rating agencies analyze the protections afforded to bondholders under the various transaction documents that form the contract between the public charter school and its bondholders. Bondholders benefit from various structural protections that rating agencies evaluate as part of the transaction analysis. These typically include real property security interests (such as a mortgage or leasehold position in the financed facility), reserve funds designed to cover potential payment shortfalls (generally funded from bond proceeds to maximum annual debt service), limitations on the issuer's ability to incur additional senior debt, and ongoing covenants requiring the school to maintain specified levels of debt service coverage and operating liquidity. All three agencies also evaluate debt structure risk factors, including refinance risk from bullet maturities, deferred amortization, variable-rate or unhedged floating-rate exposure, and the adequacy of security features such as covenant quality and bondholder remedies. The strength and comprehensiveness of these protective features can materially influence both the assigned credit rating and investor confidence. An investment-grade rating is likely to depend, in part, on the existence of a meaningful package of these features in the legal documents. (See Chapter 11 "Transaction Structure and Documentation", for more information about legal documentation.) Each transaction is analyzed individually, and no one factor is determinative; strength in one or more categories may outweigh weakness in another. Once a rating is assigned, whether above or below investment-grade, the rating must be disclosed to prospective purchasers of the bonds. Bond counsel

accordingly works closely with the underwriter and other transaction professionals to present the transaction in the best possible light to the rating agencies.

B. UNRATED BONDS

When a public charter school's bonds receive an investment-grade rating from an independent credit rating agency, the transaction typically attracts broader investor interest and may achieve more favorable pricing. Many institutional investors maintain internal policies that restrict purchases to rated securities or securities meeting specific credit thresholds. However, about half of all public charter school tax-exempt bonds have been sold without ratings based on the creditworthiness of the school. The evolving investor community analyzing public charter school bonds is largely comprised of sophisticated institutions accustomed to conducting rigorous due diligence review of credit risk prior to making an investment decision (and may also be motivated, in part, to advance the purposes of the public charter school movement through such capital investments). Thus, while a credit rating is helpful in obtaining more favorable borrowing rates, it is not a prerequisite.

Consequently, unrated charter school bonds may appeal to a more limited pool of investors, typically those with specialized expertise in the sector and the capacity to conduct independent credit analysis, which can result in higher borrowing costs for the school. Generally, as demand for such bonds narrows, the cost of the borrowing (or interest rate) increases. Thus, to the extent a public charter school is able to satisfy the various credit rating agency rating criteria, the better off it will be in accessing the lowest borrowing rates available in the market.

The following chapter examines the perspectives of some of the public charter school bond sector's most active institutional investors.

CHAPTER 7

Investor Perspectives

As described above in Chapter 6 “Credit Considerations”, investors who will buy a public charter school’s bonds do not rely solely on the assessment of a credit rating agency but instead review a breadth of available information about a school’s bonds. Many investors apply their own unique due diligence process to determine their own internal credit rating for a public charter school’s bonds, irrespective of the third-party rating agency’s assessment. In this review process, investors typically focus on similar categories of information as do credit rating agencies. However, some of the market’s most active institutional public charter school bond investors indicate that they place emphasis on particular characteristics of a transaction, as follows:¹

- 1. Governance and Leadership.** The composition of a public charter school’s leadership team, including its board of directors, is central to investor assessment, and certain investors expect to have personal interactions with board members before making an investment decision. Strong leadership includes a board of directors that is independent from the CEO, with clear separation of duties among qualified individuals across key areas of expertise necessary to guide the school. Investors seek boards with a diverse range of experience, including backgrounds in finance, accounting, management, legal, and instruction, as well as influential local community members who can assist the school in navigating political dynamics that may affect the program. Strong leadership also includes executive staff or administrators with requisite programmatic expertise and reasonable expectations about growth. Investors are particularly cautious about early-stage schools, schools with low enrollment, and schools whose management or finance functions lack sophistication; in such cases, contracting with an external CFO or comparable financial professional can meaningfully strengthen investor perception. Growth plans should

¹ The perspectives described in Chapter 7 “Investor Perspectives”, represent a summary of several informal interviews conducted by the authors. They do not represent the views of any specific investor or financial institution.

be supported by an analytical framework rather than simply the enthusiasm of a charismatic school leader.

- 2. Charter Management Organizations.** While most investors do not give preference to stand-alone public charter schools over public charter schools that are part of a network of schools commonly managed by a single entity (a CMO), or vice versa, an appropriate relationship should exist between a CMO and its schools in order to attract investors. Investors typically prefer nonprofit CMOs over for-profit CMOs because the for-profit CMO's profit motive tends to weaken managed school balance sheets over time, to the detriment of bondholder security.² For nonprofit CMOs, a self-sustaining revenue model that permits managed public charter schools to retain reserves for unexpected circumstances presents the strongest credit profile. Because public charter schools are typically financed almost entirely with debt, some investors view a measure of equity-like participation, such as management taking on subordinated debt, as a meaningful credit positive, even where it is difficult to structure in practice.
- 3. Enrollment and Revenue Projections.** Where future payment of bond debt service depends on the growth of a public charter school's enrollment and net revenues, most investors apply a variety of stress scenarios to the projections provided by the school in marketing its bonds. The strongest projections are based on conservative assumptions about future per-pupil funding, demand for the program, and major expenditure trends (such as teacher salaries). Investors may assess whether enrollment projections are based on organic growth of the school population matriculating from one grade to the next, or they may make more aggressive assumptions. Demographic trends, including declining birth rates, gentrification dynamics, and post-pandemic enrollment shifts, are commonly factored into the analysis, as are state-level regulatory changes and broader public school enrollment trends. Enrollment scale itself is a key threshold consideration: investors generally apply different analytical frameworks to schools with over 1,000 students than to those with fewer than 500, and financings for very small schools (for example, those with around 200 students) have become increasingly disfavored. Demonstrated growth in enrollment is viewed as a positive indicator. Academic performance is also a critical input, with investors looking for schools

² Special tax-related considerations come into play in the context of using tax-exempt financing for a nonprofit charter school that is managed by a for-profit CMO. The management agreement or contract between the CMO and the charter school is a key focus of this analysis.

that are academically stronger than the surrounding district, even where overall ratings are modest; the relative weakness and lack of standardization in academic disclosure remains a recognized challenge. The credibility and knowledge of the school's leadership in projecting growth and revenues are key considerations for investors.

- 4. Subjective Factors/Site Visit.** An investor in public charter school bonds will conduct a site visit before making an investment decision, especially if such investor is considering purchasing a major portion of the bonds offered for sale. Such visits provide an opportunity for investors to meet school leaders and board members in person as well as to gain a sense of the culture of the school. Parent involvement, engaged faculty and staff, and happy kids who are learning all support the conclusion that the school is in position for long-term success. In addition, the site visit can allow investors to understand the connection between the proposed construction project to be financed with the bonds and the school's program and population. Alignment of architectural design and project scale to the school's program and its financial capability is a credit strength.
- 5. Quality of Finance Team.** By virtue of their day-to-day involvement in the capital markets, the portfolio managers and analysts who assess public charter school bonds for institutional investors tend to be familiar with all of the most active underwriters and legal counsel involved in public charter school tax-exempt bond finance. Careful selection of a bond finance team is a credit strength to investors. Reputable, experienced professionals are known to many investors and lend a measure of credibility to the school's bond transaction, which becomes valuable, in particular, for a school that has never issued bonds before and is unknown to the bond market. An unsophisticated financing team, by contrast, is viewed as a meaningful negative and can itself impair a school's access to the market. Conversely, investors are wary of financial market participants that mislead schools into transaction structures and terms that are not appropriate for long-term programmatic success.
- 6. Other Considerations.** Certain investors look beyond the information that is considered standard in charter school bond assessment. Such analysis could include surveying the history of charter school revocations within the state and jurisdiction of the charter school offering the bonds in order to contextualize the legal framework and appeals process for charter authorization, as non-renewal or revocation of a charter is widely regarded as the single largest investment risk in

the sector. Data-driven, objective revocation frameworks represent the strongest protection for bond investors. Some investors contact charter authorizers directly to assess the relationship between the charter and its authorizing agency. Others review parent surveys, third-party generated school “report cards”, academic research or empirical verification of student performance, and ordinary searches through Google for publicly available information or publicity on the Internet. Covenant packages also receive close scrutiny: debt service coverage covenants that do not trigger an event of default when ratios are missed are viewed as weak, and non-market covenants generally are treated as a negative. Finally, some investors approach public charter school credits in a manner analogous to small business loans, paying particular attention to the recovery value of pledged collateral; because school facilities frequently realize substantially less in a workout than their stated value (in some cases as little as half), and because rating agencies generally do not rate for recovery or other collateral risk, internal credit assessments may be more conservative than published ratings.

The due diligence and credit review process is rigorous but warranted: with millions of dollars at stake for more than two decades, investors must gain comfort that default is unlikely. Sector performance has supported that comfort, with a low rate of loan foreclosures and write-offs even beyond tax-exempt bonds.³ As of 2022, after 25 years of issuance and nearly 2,300 tax-exempt transactions totaling more than \$41 billion, the cumulative monetary default rate of charter school bonds was approximately 4.3% by count and 2.8% by par, with an overall loss rate of just 0.9% by dollar volume. Performance has improved over time: limiting the analysis to the decade from 2012-2022 shows that default rates fall to roughly 2.1% by count and 1.6% by par. Credit quality also varies materially by rating status.⁴ Unrated charter school bonds have defaulted materially more often than rated bonds, giving investors added reason to scrutinize such credits. Rated bonds also tend to enjoy better secondary-market liquidity, an important factor for institutional buyers.

³ See “A Decade of Results: Charter School Loan and Operating Performance” (May 2011), by Ernst & Young LLP for the Low Income Investment Fund, the Reinvestment Fund, and Raza Development Fund, available at liifund.org/wp-content/uploads/2011/05/Decade-of-Results-CS-Loan-Operating-Performance-05-11.pdf, indicating that through December 31, 2010, only 1.2% of loans to charter schools had either been foreclosed or written off by lenders (excluding tax-exempt bond financings).

⁴ See “2022 Charter School Bond Sector Default Study Default And Loss Rates Continue to Decline” Published by Equitable Facilities Fund available at eqfund.org/wp-content/uploads/2023/11/EFF_Default-Study_thru-Year-End-2022.pdf.

CHAPTER 8

Credit Enhancement

For public charter schools that do not yet possess the characteristics of an investment-grade organization, credit enhancement of tax-exempt bonds may make a facilities project economically feasible by lowering the cost of the borrowing. Credit enhancement involves the guarantee by a more credit-worthy entity of the obligations of a less credit-worthy entity, such as private mortgage insurance. The guarantor takes on the risk of the obligor in exchange for a payment of money by the obligor. The greater the risk transferred, the higher the cost to the obligor. Ultimately, if the risk is too great, no price will be sufficient, and thus no credit enhancement will be available. Credit enhancement for public charter schools is an evolving industry, which has become increasingly more utilized in tax-exempt bond financing.

Credit enhancement for any type of tax-exempt bonds (not only for public charter schools) traditionally took two basic forms: bank letters of credit and bond insurance. Since the Great Recession, the bond insurance industry has materially diminished. As of this publication, no remaining bond insurance company will insure public charter school bonds. For public charter schools, however, bank letters of credit may be an option. In addition, several government-sponsored credit enhancement programs have been established in recent years. Finally, innovative forms of credit enhancement are being developed by a variety of institutional supporters of the public charter school movement. As demonstrated by the significant savings passed on to borrowers through the Equitable Facilities Fund programs, credit enhancement represents an area for innovation to expand the access of public charter schools to capital financing through tax-exempt bonds.

A. BANK LETTER OF CREDIT

Letters of credit are typically structured as short-term commitments ranging from one-to-five years to support the debt service obligations of the borrower. Letters of credit are commonly utilized in combination with variable-rate tax-exempt bond transactions, which contain structural features

more suitable for the short-term nature of a letter of credit. Using this form of credit enhancement, the public charter school's bonds can be sold with the higher credit rating of the letter of credit provider, thereby reducing the cost of borrowing. Because variable-rate bonds do not guarantee a fixed rate of interest over time but instead periodically adjust interest rates, such bonds are generally more suitable for larger, more sophisticated tax-exempt borrowers (such as large hospitals or health care networks). However, public charter schools have used letters of credit issued by local, regional, and national banking institutions to enhance their tax-exempt bonds for transactions ranging from under \$10 million to over \$20 million. Typically, banks issuing a letter of credit will require collateral assets to secure the letter of credit, in some cases in an amount equal to the principal amount of the bonds secured by the letter of credit. A variety of financial instruments (beyond the scope of this booklet) can be used in combination with letter of credit-backed variable-rate tax-exempt bonds to mitigate the risk of fluctuating interest rates over time.

The motivation to use variable-rate bonds stems from the traditionally significant lower overall borrowing costs associated with such financing arrangements, as compared with traditional fixed-rate bond structures. Because it is usually more expensive to borrow money for a longer period of time, long-term fixed-rate bonds usually have an overall borrowing rate that is higher than a variable-rate financing. While variable-rate bonds can be structured to amortize principal over a long-term period (20–30 years), they reflect the interest rate for the short-term period between the time an initial rate is set and the time the initial rate is reset to a new rate. Variable-rate bond interest rates can be structured to reset daily, weekly, yearly, or less frequently and to bear interest rates reflective of the corresponding interest rate reset periods. For example, the school could be paying interest at a weekly borrowing rate for bonds that mature in 25 years.

In addition to variable-interest rate exposure, risks associated with letter of credit backed variable-rate tax-exempt bonds include: (a) letter of credit renewal risk and (b) letter of credit provider bankruptcy. Because letters of credit are typically short-term commitments, the school must plan for either renewal or replacement of the letter of credit prior to its expiration date. There is a risk that the existing provider will not be renewed, or that no replacement provider will be willing to step forward. In addition, prior to the expiration of a letter of credit, a letter of credit provider could become insolvent or become otherwise unable to honor its obligations under the letter of credit.

B. GOVERNMENT-SPONSORED CREDIT ENHANCEMENT PROGRAMS

Six states have established programs that leverage public resources to lower the borrowing costs for charter school tax-exempt bonds.¹ These include three programs that offer a complete guarantee of the charter school's bond payments and three programs that create the right, but not the formal obligation, of a state to cover the charter school's bond payments. In addition, several states have established programs specifically to help charter schools with facility financing, including loan programs and revolving funds, although the level of funding for each program differs by state.²

The Texas Permanent School Fund (PSF) guarantees timely payment of the principal and interest on a charter school's bonds. To be eligible for the program, a charter school must obtain at least an investment-grade credit rating on its own. Further, state law limits the amount of charter school bonds that can be guaranteed. For schools that participate in the program, the bonds receive the credit rating of the PSF ("AAA" as of publication), and they should therefore be able to be sold at the lowest interest rates available.

The Arizona Credit Enhancement Board (CEB) also guarantees the full principal and interest payments on a charter school's bonds. Eligibility for the CEB program is based on Arizona's own state academic performance rating rather than on a third-party credit rating. To be eligible, a school must have an "A" academic rating. For schools that participate, bonds carry the rating of the CEB program (AA- as of publication).

The Idaho School Bond Credit Enhancement program is a two-tiered system designed to help Idaho public school districts and public charter schools obtain better credit ratings on their bonds. The first tier includes credit enhancement by the State of Idaho pursuant to which the debt service fund established for the bonds is replenished by state appropriation if drawn upon, if necessary, and the second tier includes the same credit enhancement plus a guarantee by the Idaho Endowment Fund Investment Board. The guarantee allows the State Treasurer of Idaho to borrow funds from the Public School Endowment Fund to make a bond payment if the borrower is unable to make its payment. For schools that participate in the first tier, the bonds carry a

¹ Arizona, Colorado, Idaho, Indiana, Texas and Utah.

² See Arkansas: Ark. Code Ann. § 19-5-1251 (2024); California: treasurer.ca.gov/csfa; District of Columbia: osse.dc.gov/service/facilities-financing-dc-public-charter-schools; Louisiana: La. Stat. Ann. § 17:4001; New Mexico: nmfinance.com/charter-school-facility-revolving-fund; and South Carolina: treasurer.sc.gov/what-we-do/for-governments/bond-and-debt-information/charter-school-facility-revolving-loan-fund-program-csfrlf.

rating of Aa1 by Moody's and AA by S&P Global Ratings, and under the second tier, the bonds carry a rating of Aaa by Moody's and AAA by S&P Global Ratings (as of publication).

Additionally, as of this publication, Oklahoma is considering a bill³ that would establish the Charter School Bond Credit Enhancement Program, which would create the Charter School Bond Credit Enhancement Fund from which funds would be paid if a charter school cannot make its own debt service payment. The bill was passed by the House of Representatives and is moving through consideration in the Senate. If the bill passes, it will become effective November 1, 2026.

While Texas, Arizona, and Idaho formally dedicate designated public resources to guarantee charter school bonds, the states of Colorado, Utah, and Indiana make certain state reserves available to pay the principal and interest on bonds of charter schools in their programs. However, these payments are not guaranteed, and they instead remain subject to appropriation if and when such payments are needed. This type of obligation is referred to as a "moral obligation" (as opposed to an enforceable obligation). For charter schools that participate in these programs, bonds receive ratings upgrades but do not carry the same credit ratings as direct obligations of the respective states.

C. OTHER GUARANTORS AND CREDIT-ENHANCEMENT VEHICLES

As the public charter school movement enters its fourth decade and access to facilities financing remains a challenge, the need for nontraditional forms of credit enhancement has gained prominence. As described above, credit-enhancement programs for public charter school tax-exempt bonds that have been developed by federal⁴ and state⁵ agencies may serve as models for future program development.

³ Okla. H.B. 3372, Legislative Session, 60th Leg. (Okla. 2026); oklegislature.gov/BillInfo.aspx?Bill=hb3372&Session=2600.

⁴ For example, the U.S. Department of Education maintains the Credit Enhancement for Charter School Facilities Program, which can be utilized to provide credit enhancement for charter school tax-exempt bonds as well as other types of charter school facilities financing. The U.S. Department of Education grants federal credit enhancement funding resources to various programs across the country (through both governmental and private nonprofit organizations). For further information, see ed.gov/grants-and-programs/grants-birth-grade-12/charter-school-programs/credit-enhancement-charter-school-facilities-program.

⁵ As described above, see: the State of Colorado program information: treasury.colorado.gov/programs/support-for-charter-schools; the State of Texas Permanent School Fund information: texaspsf.org; the State of Utah program information: ucfsa.utah.gov/credit-enhancement-program; the State of Arizona program information: azleg.gov/ars/41/05855.htm; the State of Idaho School Bond Credit Enhancement Program information: efib.idaho.gov/school-bond-credit-enhancement-program and sto.idaho.gov/Debt-Management/Idaho-School-Bond-Guaranty-ISBG; and the Indianapolis Local Public Improvement Bond Bank program: indianapolisbondbank.com/indianapolis-bond-bank-in/about/i3865.

In the Third Edition, we observed that several reform-oriented charitable foundations have invested substantially in the public charter school movement, impacting charter facilities policy development broadly, as well as supporting high-performing individual schools. Such foundations could leverage their financial resources in a variety of ways to enable public charter schools to access tax-exempt financing (that might not otherwise be eligible) and to lower the school's borrowing cost. Approaches could include: (a) guaranteeing a school's timely debt service payments (akin to a bond insurer), (b) purchasing a subordinate portion of a project's tax-exempt debt (thereby "deleveraging" the school's balance sheet from the tax-exempt bond investor's perspective), and (c) pledging a pool of funds to perform either of these functions for a regional or state-wide portfolio of facilities projects. The latter example of pooling philanthropic resources has been successfully demonstrated through the establishment of Equitable Facilities Fund and other philanthropic revolving loan funds.

CHAPTER 9

Financing for CMOs

This chapter explains how networks of commonly managed charter schools (CMOs) enhance the credit strength of their bond financings by leveraging their scale, applying the concept of “strength in numbers,” to obtain lower bond interest rates than otherwise available through “stand-alone” transactions. The approach is commonly referred to as an “obligated group” in the charter school bond market and has emerged as the market standard credit structure for CMOs using tax-exempt bonds.

The credit strength of charter schools is generally riskier than that of traditional school districts. Thus, as discussed previously, charter school bond interest rates are generally higher. For stand-alone charter schools (operating one school at a single site), non-renewal or revocation of the charter contract would likely cause a default on the charter school’s bonds and losses for the bond investors. For CMOs, however, this risk is mitigated in certain respects. Each additional school in a network represents another example of successful charter approval and operation. As the first schools in a network obtain charter renewals, reach full enrollment, and establish track records of success, the institutional knowledge is transferred to newer schools in the network, and the risks of non-renewal or revocation for all schools in the network are reduced. In other words, successful CMOs are viewed as more credit-worthy organizations, in part, by virtue of their scale and repetitive successes.

As a borrower, one goal in structuring a loan is to balance the desire to make the fewest promises to a lender, with the need to make enough promises that motivate lenders to loan money at reasonable borrowing rates. In theory, the more restrictive loan terms are, the more security lenders obtain, and thus the lower rates they should be willing to lend money. Applied to CMOs, the highest level of security a CMO could provide to a lender would be a security interest in virtually all its revenues and fixed assets across the system. However, as a practical matter, it makes no sense for a CMO to leverage ten schools to finance the construction of an eleventh. Moreover, many state laws would prohibit such an arrangement.

Thus, the challenge faced by growing CMOs in the late 2000s was how to give bond investors security that reflected the strength of the network, the benefit of the institutional knowledge developed across so many successful schools, while balancing the state law limits and practicalities of resource allocation. How could CMOs get credit for their institutional success and scale, without “mortgaging the farm” or overpromising to lenders?

In the 1980s, Orrick attorneys developed the obligated group structure to enable growing healthcare systems (networks of commonly managed hospitals) to pool the revenues derived from hospital campuses located around the U.S., as security for periodically issued tax-exempt bonds. The obligated group gave bond investors a parity claim on all pledged assets, which included hospital campuses in multiple states or jurisdictions, resulting in a stronger credit than individually financed projects. Certain hospitals could be included in the obligated group, while others could be excluded, allowing the healthcare system to balance competing objectives.

In 2010, Orrick attorneys adapted that financing structure to a growing mid-western charter school management organization, enabling the simultaneous financing of campuses in multiple states on a pooled basis and achieving economies-of-scale to lower transaction costs and borrowing costs. The adaptation of the obligated group structure to growing CMOs created a mechanism for CMOs to effectively balance the issues outlined above, providing investors greater security while allocating resources in a manner consistent with internal policies and state law.

A. HOW DOES AN OBLIGATED GROUP WORK?

In a typical obligated group financing structure, a nonprofit charter management organization creates a sister nonprofit organization, established solely to support the CMO, and intended exclusively to own facilities and undertake financing. This supporting organization (call it “Support Org”) becomes the central figure in the obligated group. For illustrative purposes, imagine a CMO has ten schools. Five are in permanent facilities (former district sites, grant-funded or donated facilities, etc.), and the other five are in temporary spaces (leased parochial school buildings, leased former retail spaces, etc.) seeking permanent facilities. CMO identifies two sites, completes plans, obtains permits and seeks tax-exempt financing. The obligated group is used in this scenario to allow the CMO to leverage the

experience and credit-worthiness of its entire network, while only pooling the resources of the two schools that will move into the new sites.

Support Org will borrow tax-exempt bond proceeds and use the proceeds to acquire the two sites and build the new facilities. Support Org will lease the two sites to the CMO, one site for each school, which provides Support Org with rental income and the ability to mortgage the land and buildings at the two sites. Support Org, as the borrower, can provide investors with substantial security by pledging all of its revenues and fixed assets to secure payment of the bonds. Through this approach, bond investors obtain a traditional pledge of all the assets of the borrower, and comfort from the fact that the two schools in the financed facilities benefit from the institutional knowledge of the entire ten-school network.

Over time, Support Org may identify three additional sites for the three remaining schools in the CMO's network that need permanent facilities. The obligated group documentation allows Support Org to undertake additional tax-exempt bond financings over time, and add those additional sites and rental income to the security for all the previously issued bonds of Support Org. The principle of "strength in numbers" comes into play for the later issued bonds, as Support Org is able to obtain lower interest rates on bonds secured by a growing (from two-to-five) pool of collateral. This arrangement is characterized as a form of credit enhancement because the last school to obtain financing in an obligated group structure borrows at a rate that is lower than it would otherwise have been able to obtain on a "stand-alone" basis. The later transactions are thus "enhanced" by the pooling effect of combining the substantial revenues and collateral of the earlier transactions with the later transactions in the obligated group. And, the five schools that did not need financing for facilities remain outside the obligated group, their resources unencumbered by Support Org's bonds.

B. CURRENT APPLICATION

The obligated group approach can be tailored to address specific organizational needs of successful CMOs beyond credit enhancement of bonds. For example, operation in multiple jurisdictions may give rise to the need for the use of multiple conduit governmental issuers for tax-exempt financing. Facilities costs can vary significantly from one geography to another, or even from neighborhood to neighborhood within the same city, presenting equity issues across networks. CMOs with significant operational

history may have accumulated substantial operating reserves, seeking a means to leverage the value of years of sound financial management to maximize the efficiency of bond financing. CMOs may have, as outlined above, the desire or need to finance only a few sites across a much larger network of facilities, leaving others unencumbered. Also, CMOs may seek to combine various types of debt financing across various facilities projects over time, using tax-exempt bonds, but also traditional commercial bank loans, New Markets Tax Credits, nonprofit CDFI loans, and philanthropic subsidized loans. All of these dynamics can be addressed and objectives achieved through a carefully structured obligated group model.

CHAPTER 10

Market Disclosure

The capital markets obey the fundamental economic rule of supply/demand. Thus, one consideration in undertaking borrowing with tax-exempt bonds is the determination as to whether bonds will be offered for sale to the public capital markets (a “public offering”) or instead privately offered to one or a select few investors (a “private placement”). Invariably, the broader a market for a public charter school’s bonds, the lower the cost of funds (or interest rates) the school will be able to obtain. Thus, a public offering, if possible, is almost always expected to be more favorable than a private placement. In either case, the school must provide initial and ongoing information to investors about itself and its bonds. This chapter describes various aspects of public offering versus private placement of tax-exempt bonds.

A. PUBLICLY OFFERED BONDS

The offering and sale of securities is regulated by federal laws codified primarily in the Securities Act of 1933 (the “Securities Act”) and the Securities Exchange Act of 1934 (the “Exchange Act”). Public charter school bonds constitute “securities” for purposes of the Securities Act and the Exchange Act. For most corporate securities, a public offering must be preceded by filing a registration statement with the SEC pursuant to the Securities Act, and the corporation is required to make periodic reports to the SEC pursuant to the Exchange Act. Municipal securities, moreover, including those of most public charter schools, are exempt from the registration requirements of the Securities Act and from the reporting requirements of the Exchange Act. However, the offering and sale of public charter school bonds is not exempt from the anti-fraud provisions of the Securities Act or the Exchange Act. In addition, the SEC’s rules governing underwriters of municipal bonds effectively require public charter schools to make periodic disclosure of certain information relevant to the security of their bonds unless certain exemptions apply.

1. Official Statement. The offering document in a public offering of public charter school bonds is usually called an "official statement." If the bonds are being offered on a more limited basis, the offering document might be called an "offering circular", a "private placement memorandum", or a "limited offering memorandum." In any case, the offering document contains the school's official statements; that is, the statements about itself, its financial condition, the bonds, the project to be financed with the bonds, and the sources of repayment of the bonds upon which it intends investors to rely. A preliminary official statement is distributed before the official statement and before the financing terms are final. It is used by the underwriter to solicit interest in the bonds. The final official statement contains the final terms of the financing, including the principal amounts, interest rates and maturity dates of the bonds, and the uses of the bond proceeds.

To determine what ought to be contained in a public charter school's official statement, the school and its financing professionals must carefully consider the school's situation and the terms of the bonds proposed to be issued. From these, they must form a judgment as to what information is required or should be included to ensure that the official statement (i) contains the information needed for a potential investor to make an informed investment decision, and (ii) does not contain any material misstatements or omissions. The threshold for adequate disclosure is the concept of materiality: information is deemed "material" if there is a substantial likelihood that knowledge of that information would be important to a reasonable investor's decision. What information is material in any given case depends, of course, on the circumstances of the issuing school and the nature of the bond issue.

Coordination of the preparation of the official statement is generally undertaken by the school's disclosure counsel. This party prepares a draft official statement on the basis of information provided by the school (with respect to itself, its operations and its financial condition) and the terms of the financing documents prepared by bond counsel (with respect to descriptions of financing documents and tax law matters). Different members of the financing team review and comment on different portions of the official statement drafts, often as part of scheduled drafting sessions. Parties also conduct a "due diligence" investigation with respect to the official statement involving inquiries of school officials and review of supporting documentation.

A preliminary official statement and an official statement are generally not printed and distributed until all concerned parties are comfortable that the information included is accurate and complete.

2. Public Charter School Responsibilities. The anti-fraud provisions of the Securities Act and the Exchange Act require that the information provided in connection with the offer or sale of securities must not contain any untrue statement of a material fact and must not omit to state a material fact necessary to make such information not misleading. This is of critical importance to the public charter school. The school is primarily liable for any material misstatements or omissions regarding its operations or finances made in the documents used to offer and sell the school's securities. The school may not transfer this primary liability to its underwriter, general counsel, bond or disclosure counsel, or any of the other parties involved in the financing. Such parties might be liable in their own right, but their liability will not absolve the school of its primary liability. Consequently, the school and its staff must make every effort to ensure that the school's offering documents are accurate and complete, and that the bond counsel and disclosure counsel are of the highest quality and have significant resources.

3. Underwriter Obligations and Rule 15c2-12. Underwriters of municipal securities are also subject to the anti-fraud and other provisions of the securities laws. To protect themselves from liability, underwriters (usually with the assistance of their counsel) must conduct an investigation of the public charter school's affairs and generally will require, as a condition to their obligation to purchase the bonds, the delivery of certifications and opinions as to the completeness and accuracy of the school's offering materials.

In addition, Rule 15c2-12, adopted by the SEC under the Exchange Act, places specific burdens upon the underwriters of municipal securities. First, unless an exemption is available, Rule 15c2-12 requires an underwriter, prior to any bid, purchase, offer, or sale of a municipal security, to obtain and review the official statement which the issuer "deems final as of its date," exclusive of certain pricing and underwriting information. In order to comply with Rule 15c2-12, the underwriter generally requires the public charter school to certify that it deems the preliminary official statement final as of its date (the date it is electronically posted or printed). Second, unless an exemption is

available, Rule 15c2-12 also requires the underwriter to contract with the issuer to receive a sufficient number of copies of a final official statement within seven business days after the final agreement to purchase bonds. As a result, such an undertaking on the part of the school is now typically included in the bond purchase agreement.

Rule 15c2-12 also requires the underwriter to obtain a commitment from the public charter school to provide continuing disclosure during the entire life of the bond issue, including a commitment to disclose certain material events whenever they occur. (See “Continuing Disclosure” below.) Generally, Rule 15c2-12 exempts from its requirements primary offerings of bonds in authorized denominations of \$100,000 or more, if such bonds (i) are sold to no more than 35 sophisticated investors purchasing for their own accounts, (ii) have a maturity of nine months or less, or (iii) at the option of the bond owner, will be repurchased from the bond owner at no less than par, at least as frequently as every nine months. In addition, certain public charter schools and certain bond issues are exempt from the continuing disclosure requirements discussed below.

4. Continuing Disclosure. SEC Rule 15c2-12 requires issuers of municipal bonds and certain other “obligated persons” to contract to provide continuing information during the life of their bond issues. The three exemptions from Rule 15c2-12 described above apply to these requirements. In addition, issues maturing in 18 months or less are exempt from the annual disclosure requirement, and only limited annual disclosure is required of public charter schools with less than \$10 million in outstanding bonds at the time of the issuance. Nevertheless, these exemptions do not excuse qualifying schools from the disclosure of certain material events.

Rule 15c2-12 requires the underwriter of \$1 million or more in municipal securities to “reasonably determine” that each issuer and any other “obligated person”¹ has undertaken in a written agreement (typically referred to as a continuing disclosure agreement) for the benefit of holders of the securities to provide (by filing with certain specified information repositories) four categories of information:

¹ An “obligated person” is defined to mean “any person who is either generally or through an enterprise, fund, or account of such person committed by contract or other arrangement to support payment of all, or part of the obligations on the municipal securities to be sold.” It is generally accepted that a person’s obligation must be for a material portion of the annual debt service in order for that person to be an obligated person. For charter school bonds, the charter school is ordinarily the only obligated person.

A joint powers authority acting as the issuer on behalf of a charter school is not deemed an obligated person, because the source of debt service is the charter school.

- Certain “annual financial information”, of the type presented in the official statement, for each obligated person for whom financial information or operating data is presented in the final official statement, or for obligated persons meeting certain objective criteria.
- Audited financial statements of the obligated person(s), when and if available, if not provided with the annual financial information.
- Notice of the occurrence of certain extraordinary events (as specified in the Rule) in a timely manner.
- Notice of any failure to file the required annual financial information. The promise to make the annual reports and the material event reports must be included in a document or agreement which is enforceable by bond owners, such as an indenture, must be reflected in the bond purchase agreement, and must be described fully in the official statement. Non-compliance must be reported to the repositories and disclosed in future official statements for five years, with possible adverse market consequences for the school’s bonds.

5. Interplay of Rule 15c2-12 and the Anti-Fraud Provisions. The SEC’s anti-fraud rules apply to disclosures intended to influence securities markets. Under accepted legal principles, annual reports and material event disclosures must therefore be accurate and not omit any material information needed to make the disclosures not misleading. Material misstatements or omissions in the annual or event reports may be the basis for claims of securities fraud under federal or state securities laws, actionable by the SEC or private plaintiffs (bond owners or other investors), with substantial potential liability for the school.

B. PRIVATE PLACEMENT OF BONDS

The first tax-exempt financings undertaken by public charter schools were privately placed bonds; almost necessarily, given the uniqueness of public charter schools and the fact that no such bonds had theretofore been issued or sold in the capital markets. Over time, with greater market understanding of public charter school bonds, public offering has become the standard method of sale. As described above, the general rule is that a public offering

will elicit the lowest cost of borrowing. However, certain conditions may make private placements at least worth considering:

1. In some cases, a school may have a private foundation or high net worth individual or institution that is interested in directly supporting the project financing, and would be interested in offering attractive pricing for the private purchase of the bonds.
2. A school may not be able to sell bonds on the public markets, due to credit issues (such as limited operating history, or other unique characteristics), but must complete a facilities project in order to continue operations, and therefore may seek a private placement to a specialized category of institutional high yield investor (where the cost of capital will likely be highest).
3. Certain governmental agency financing programs may require the school to issue a tax-exempt security for private purchase in order to effectuate the financing of the project.

The disclosure rules described above in (A) do not apply to privately placed bonds because they are not offered for sale to the public, with the exception of the anti-fraud rules which apply to any disclosure made in connection with the offer or sale of securities. No official statement or continuing disclosure is required. However, as a practical matter, investors in private placement financings will typically require similar disclosure to that required under SEC rules, and in some cases require more detailed continuing disclosure than would otherwise be required in a public offering.

CHAPTER 11

Transaction Structure and Documentation

There are a number of variations in the structure of tax-exempt financings for public charter schools. Nonetheless, the following is illustrative of the basic model:

1. The Bonds are issued by a state or local governmental entity (the "Issuer") which, under applicable state law, has the power to issue bonds for nonprofit corporations, including public charter schools (the "Borrower") for projects or purposes (the "Project") of the type proposed.¹ The Bonds are issued pursuant to an indenture or trust agreement (the "Indenture") between the Issuer and a trustee bank (the "Trustee"). The Trustee holds the bond proceeds until requisitioned for the Project, plus the debt service reserve fund and the bond repayment fund.
2. The Bonds are sold by the Issuer to an underwriter or underwriters (the "Underwriters") pursuant to a bond purchase agreement (the "Bond Purchase Agreement") between the Issuer and the Underwriters, which is approved by the Borrower. The Bonds are resold to investors in the tax-exempt market using an official statement (the "Official Statement") describing the Bonds and other information that investors would want to know in deciding whether to buy the Bonds, which includes financial and operating information about the public charter school that will use the financed facilities.
3. The proceeds of the Bonds are loaned to the Borrower² pursuant to a loan agreement (the "Loan Agreement") between the Borrower and the Issuer (which assigns most of its rights, including the right to receive repayments of the loan from the Borrower, to the Trustee as security for the Bonds pursuant to the Indenture). The Loan Agreement sets out the terms of repayment of and security for the loan. There may or may

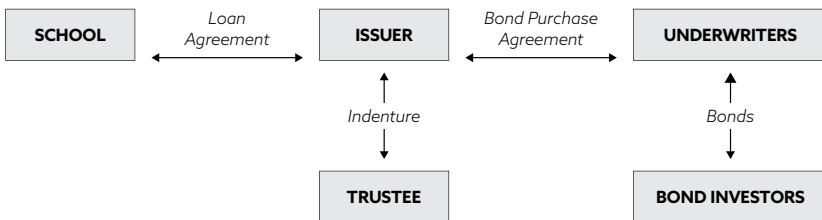
¹ Each state has a different statutory environment for issuing tax-exempt bonds for public charter schools. Therefore, bond counsel should be consulted regarding the specific procedures and approvals that may be applicable to the issuance of tax-exempt bonds for public charter schools in your state.

² Under certain circumstances, a tax-exempt loan also may be made to a nonprofit corporation that is affiliated with or controlled by the public charter school, or to a special purpose entity such as a limited liability company (that is disregarded for tax purposes) created to own the financed facility.

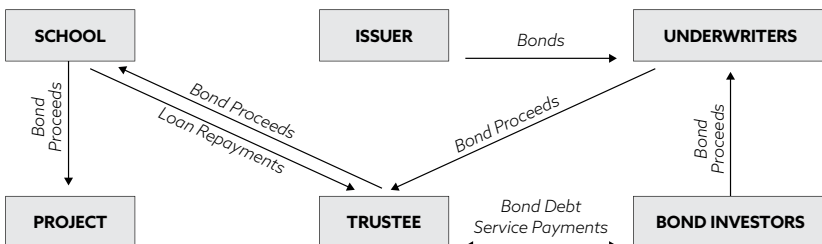
not be a deed of trust on the Project or other property to further secure the loan. If so, it is also assigned to the Trustee.

- The proceeds of the Bonds are used by the Borrower to finance the Project, fund the debt service reserve fund, and pay costs of issuance. A separate public entity is required to issue the Bonds, because only public entities are qualified under the Internal Revenue Code to issue bonds the interest on which is exempt from federal income tax. However, the nonprofit corporation public charter school is the true party-in-interest and the true obligor of the Bonds. The Issuer functions as a conduit, passing the Bond proceeds collected from Bond investors by the Underwriters (net of the Underwriters spread or fee) to the Borrower and the loan repayments received from the Borrower back to the holders of the Bonds, in each case through the Trustee. The Issuer is not liable on the Bonds except to apply amounts received from the Borrower pursuant to the Loan Agreement as provided in the Indenture. Having assigned its rights under the Loan Agreement (except the right to receive payment of any fee or indemnification) to the Trustee, the Issuer generally has no role or a very limited role after issuance of the Bonds. The Trustee takes over at that point to collect, maintain, and disburse the moneys, and enforce the rights assigned to it by the Issuer under the Loan Agreement.

The Documents



The Money Flow



The documents of primary interest to the charter school are the Loan Agreement and the portion of the Official Statement describing the public charter school's finances and operations. The Loan Agreement will typically contain a number of representations about the Borrower and a variety of covenants, usually including covenants pertaining to the following: the amount and times of amortization and repayment of the loan, including option to prepay; a pledge and security interest of general or project revenues of the charter school; maintenance of corporate existence and mergers; maintenance of its charter; limitations on encumbrances, indebtedness, acquisition, and disposition of property; financial ratios (such as income to debt service and/or assets to liabilities); maintenance and operation of facilities; insurance; indemnification of the Issuer; events of default and remedies. These terms will vary considerably with the circumstances of the public charter school and, possibly, the nature of the Project, but are generally less onerous than those found in an equivalent bank or other conventional loan agreements.

As described above in Chapter 10 "Market Disclosure", the Official Statement is the disclosure document used in most tax-exempt bond financings. It describes the Bonds and contains the information material to bond investors in deciding whether or not to purchase the Bonds. It may involve some effort on the part of the public charter school personnel to compile this information, and the school will be responsible for certifying that the portion of the Official Statement pertaining to it, meets the federal securities law standard of not containing any misstatement of material fact or omitting to state any material fact necessary to make the statements contained therein, in light of the circumstances under which made, not misleading. If the Bonds receive a credit rating, then the rating will be included on the cover of the Official Statement.

In some cases, the Bonds will be credit enhanced by a letter of credit or some other mechanism. In that case, there will be an additional contract between the Borrower and the credit provider, containing additional covenants, and payment of the Bonds may then depend more on the credit provider than the Borrower, which may afford an opportunity, in effect, to replace information in the Official Statement about the public charter school with information about the credit provider.

CHAPTER 12

Steps to Issuing the Bonds and the Finance Team

A. STEPS

While there are variations depending on the type of Issuer, the type of Project, applicable state law, policies and procedures of the Issuer, and other factors, the following is illustrative of the basic steps in a typical tax-exempt bond issue for a public charter school:

- 1. Engage the Underwriter.** The Underwriter is an investment banking firm, selected by the charter school, that is responsible for marketing the bonds: to help structure the financing, to organize the charter school's financial information for inclusion in the Official Statement and for presentation to the rating agencies to obtain ratings on the bonds and/or to credit providers, and to purchase (i.e., underwriting) the bonds for resale to investors. The Underwriter's counsel is primarily responsible for preparing the Bond Purchase Agreement and may prepare the Official Statement. Consulting an Underwriter with experience in structuring and marketing tax-exempt bonds for public charter schools early in the process is crucial in determining whether there is a market for the school's bonds, what may be the expected rating and interest rates, and working out the basic structure of the financing with Bond Counsel.
- 2. Consult Bond Counsel.** Bond Counsel is the law firm primarily responsible for rendering an opinion on the validity and tax exemption of the bonds and for drafting the legal documents to be executed by the public charter school and the Issuer in connection with the bond issue and may prepare the Official Statement. While Bond Counsel typically represents the Issuer, and the school is represented by its own counsel, Bond Counsel's fees (like all other expenses of the transaction) are paid by the charter school, and most Issuers permit the school to choose or at least recommend Bond Counsel. It is important to have a Bond Counsel experienced in public charter school bond financings and given the tax driven nature of most such financings, particularly experienced in

the complex tax laws that govern the tax-exemption of interest on the Bonds.

To pause for a brief pitch: *Orrick, Herrington & Sutcliffe LLP is the leading bond counsel firm in the country (ranked number one for more than two decades) with unparalleled expertise and experience in the tax laws applicable to tax-exempt bonds generally, and particularly their application to tax-exempt bonds for public charter schools.*

It is important to involve Bond Counsel early to determine whether the charter school and the project it wishes to finance are eligible for tax-exempt financing and to help design the basic legal and structural conditions for such a financing. Most bond counsel will provide preliminary advice on these matters without charge, in case the transaction proceeds no further.

- 3. Adopt Reimbursement Resolution.** (See discussion in Chapter 4 “Eligible Uses of Bond Funds: Reimbursing Prior Capital Expenditures”.) Bond counsel will normally provide this resolution on request without charge.
- 4. Determine with Bond Counsel and Underwriter what public entity will serve as the Issuer of the Bonds.** In some states or in some situations, there may be several possible issuers with different policies, procedures, politics, governing laws, applications, and fees.
- 5. Bond Counsel prepares and circulates to the working group initial drafts of Indenture and Loan Agreement.**
- 6. If applicable (see Chapter 10 “Market Disclosure”), the charter school works with the Underwriter** and disclosure counsel (either bond counsel or underwriter’s counsel may serve in this role) to prepare a draft of the portion of the Official Statement that sets forth the relevant financial and operating information about the school and/or the Project.
- 7. Underwriter’s counsel prepares and circulates to the working group initial draft of Bond Purchase Agreement;** disclosure counsel prepares and circulates to the working group initial draft of the Preliminary Official Statement.
- 8. One or two rounds of meetings or conference calls to discuss the foregoing documents** followed each time by circulation of revised drafts.

- 9. Draft documents are submitted to the rating agencies and/or credit enhancement providers, if applicable.**
- 10. Another round of document review** to take into account any comments or requirements of the rating agencies, etc. followed by circulation of substantially final drafts.
- 11. Meeting of the governing board of the public charter school to approve the Bond issue** and authorize execution of the legal documents to which it is a party or signatory.
- 12. Hearing on and approval of the Bonds by the Issuer** (or government entity in which the Project is located, if not the Issuer) after at least 14 days of published notice (usually combined with step 13).
- 13. Meeting of the governing board of the Issuer to adopt the bond resolution** authorizing issuance of the Bonds and execution and delivery of the legal documents and distribution of the Official Statement.
- 14. The Underwriter mails the Preliminary Official Statement to potential purchasers of the Bonds** (or posts it on the Internet and emails notice of its availability).
- 15. Pricing of the Bonds** (i.e., setting the interest rates to be borne by the Bonds) by the Underwriter (based on interest by investors) in consultation with the Issuer and the school.
- 16. Sale of the Bonds** by execution of the Bond Purchase Agreement between the Issuer and the Underwriter, approved by the school.
- 17. Preparation of a final Official Statement** containing the final sale information for delivery to purchasers of the Bonds at or before receipt of their purchase confirmations.
- 18. Closing:** delivery of the Bonds to the Underwriter in exchange for the purchase price and funding of the charter school's loan, simultaneously with delivery of final executed copies of the legal documents, and various certificates, receipts and opinions.

B. TIMETABLE

A typical Bond issue for a nonprofit corporation takes approximately 90–120 days from start to finish. For example, assume at least 30–40 days for steps 1–7 (i.e., structuring the issue and circulating first drafts of the basic legal

documents), another 40–60 days for steps 8–13 (i.e., finalizing documentation and obtaining approvals, ratings and, if applicable, credit enhancement), 7–10 days for steps 14–16 (i.e., for the Underwriter to market the bonds), followed in about two weeks with step 18 (the closing).

These timeframes are fairly representative but may in each case take a lot longer if circumstances require.

C. OTHER ESSENTIAL MEMBERS OF THE FINANCE TEAM

Municipal Advisor or Financial Advisor. The financial advisor assists the charter school with the structure, timing, marketing, fairness of pricing, and terms of a bond financing. Financial advisors can also help with the process of obtaining a bond rating. In addition, they can provide an analysis regarding whether to sell the bonds in a public or private transaction. Financial advisors may be one of the first participants to be hired in a bond financing, because their analysis and guidance can be instrumental in the charter school’s decision-making process as to whether or not to proceed with a bond financing.

Over the last few years, charter schools and their management organizations have increasingly sought to utilize the services of financial advisors. This has been done in part because some of the financings have become more complex, and also as a response to the Dodd-Frank Act.¹ Section 975 of the Dodd-Frank Act amended Section 15B of the Securities and Exchange Act of 1934 and made it unlawful for an “advisor” to provide advice to a municipal entity or obligated person (which includes charter school borrowers and affiliates) with respect to municipal securities (which includes charter school bonds) without registering with the SEC as a “municipal advisor”. As a result, underwriters and other market participants are prohibited from providing advice with respect to municipal securities unless the entity can fit within certain exemptions. For example, an underwriter can provide advice on the structuring of the bond transaction as long as it was hired for that transaction, was in response to a request for underwriting services, or if it relied on the fact that the issuer or borrower retained the services of an independent municipal advisor and documented that reliance. The reason behind this amendment is that the SEC believed that the responsibilities and duties of market participants were not well-defined, which resulted in issuers

¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 975, 124 Stat. 1376 (2010) (codified at 15 U.S.C. § 78o-4).

and borrowers receiving advice from participants who just wanted to make a profit. Consequently, the SEC sought to limit the number of parties who provide advice to the issuer or borrower in a municipal finance transaction and when those parties can provide such advice.

Importantly, the Dodd-Frank Act specifies that municipal advisors owe their issuer clients a "fiduciary duty" which encompasses the duty of loyalty and duty of care, and their charter school (obligated person) clients a duty of care. See definitions as follows:

- **Duty of Loyalty:** requires the fiduciary to act in its client's best interests without regard to its own financial or other interests, and to disclose conflicts of interest that might impair its ability to fulfill this duty.
- **Duty of Care:** a fiduciary must be qualified to undertake its engagement and consider alternatives that might better serve its client's interests.

Borrower's Counsel. The public charter school's general counsel (typically an outside law firm) will represent the school in the transaction and be responsible for reviewing and negotiating provisions of all documents to which the school is a party. In addition, in order to deliver its final opinion regarding the Bonds, Bond Counsel will rely on an opinion of Borrower's Counsel regarding the tax-exempt status of the public charter school, the validity of the actions it has taken to approve the financing, and its good standing under state law, among other matters.

Disclosure Counsel. Disclosure Counsel takes primary responsibility for drafting the Official Statement and conducting the due diligence inquiry into the operations and finances of the school. To minimize issuance costs, it is not necessary to hire a separate law firm to serve as Disclosure Counsel, but instead, either Bond Counsel or the Underwriter's counsel can serve in this role.

Trustee. A national trustee bank typically serves as bond Trustee, acting to collect, maintain, and disburse the moneys in connection with the bonds and enforce the rights of bondholders. The Issuer may select the Trustee based on its preexisting relationship in connection with previous bond issues. If not, the school may select a trustee bank. The Trustee often serves an additional key role, that of dissemination agent, responsible for receiving and transmitting the school's annual report (under its Continuing Disclosure Agreement) to the appropriate information repositories.

Investment Advisor/Bidding Agent. As described in Chapter 4 “Eligible Uses of Bond Funds”, the charter school may seek to utilize a structured investment to maximize interest earnings on funds held by the Trustee. An investment advisor or bidding agent assists the school in determining the optimal structure for such investments and assists in complying with the public bidding rules applicable to the procurement of such investments. Historically, the Underwriter could serve in this role; however, recent federal regulations require an independent investment advisory firm be retained for this limited purpose, if applicable.

Rebate Analyst. As described in Chapter 4 “Eligible Uses of Bond Funds”, a tax filing is required in the fifth year following issuance of the bonds to report any arbitrage earnings to the IRS and provide for payment of any rebate liability that may be associated with investment earnings on the bond proceeds. Rebate analysts often charge a nominal fee to undertake annual monitoring of the investment earnings and responsibility for the required rebate filing.

Post-closing Compliance Monitor. To assist the public charter school in meeting ongoing post-issuance compliance responsibilities, a compliance monitor should be engaged to undertake a variety of responsibilities, including periodic private use review and tabulation, private activity bond monitoring and analysis, internal audits, completion of new IRS Schedule K (annual reporting requirements for tax-exempt bonds applicable to nonprofit corporations), analysis of post-issuance tax compliance procedures (such as rebate filings), and review of tax documentation and recordkeeping procedures. A compliance monitor can typically be engaged to perform the rebate analyst’s role as well. (See Chapter 14 “Post-Issuance Compliance”, for more discussion of the responsibilities of the charter school after issuance of the bonds.)

CHAPTER 13

Federal Tax Rules

Public charter schools often finance their facilities using the proceeds of tax-exempt bonds, loans, and other debt instruments (collectively, “bonds”). This chapter describes the basic federal tax rules applicable to tax-exempt bonds issued to benefit public charter schools. All references herein to a charter school are with respect to a public charter school. With respect to charter schools, the tax-exempt bonds are issued by or on behalf of a state and local government (a “conduit issuer”) that loans the proceeds of the bonds to the charter school. Payments of principal and interest by the charter school on this loan are used by the conduit issuer to pay the principal and interest on its bonds. Sections 103, 141 through 150 of the Internal Revenue Code of 1986, as amended (the “Internal Revenue Code”) and the related Treasury Regulations (the “Regulations”) set forth the federal tax law applicable to the tax-exempt bonds. Most public charter schools are created under state law as nonprofit organizations and are exempt from federal income taxation pursuant to Section 501(c)(3) of the Internal Revenue Code. Accordingly, most tax-exempt bonds issued to benefit public charter schools are issued as “qualified 501(c)(3) bonds” pursuant to Section 145 of the Internal Revenue Code.

A. GENERAL

The Internal Revenue Code provides for two categories of tax-exempt bonds that may be issued by or on behalf of state and local governments — “governmental bonds” that finance facilities owned by the governmental entity and used by the general public or by the government entity itself, and “private activity bonds” that finance facilities or loans used for governmental purposes but provide significant benefit to private businesses. Notwithstanding the rule that interest on bonds issued by state and local governments is generally tax-exempt, the interest is taxable if the bonds constitute (a) arbitrage bonds (i.e., bonds issued for the main purpose of deriving arbitrage profits), (b) impermissible private activity bonds (i.e. bonds issued to finance facilities used by or for the benefit of a private business and are not specifically permitted by the Internal Revenue Code), or (c) hedge bonds (i.e., bonds issued too far in advance of the time the bond proceeds

are expected to be spent). The arbitrage bond prohibition has two important components: arbitrage yield restrictions and rebate requirements. Private activity bonds may only be issued as “qualified bonds” for the purposes listed in the Internal Revenue Code.¹ The hedge bond rules focus primarily on the timing of the issuance and the investment of the proceeds prior to expenditure.

1. Arbitrage Yield Restriction.

With respect to arbitrage yield restrictions, the Internal Revenue Code generally prohibits the issuance of tax-exempt bonds if the issuer reasonably expects to use the proceeds of such bonds, directly or indirectly, either (i) to acquire securities or obligations with a yield materially higher than the yield on such bonds, or (ii) to replace funds used to acquire such higher yielding securities or obligations. Thus, the Internal Revenue Code restricts the rate of return on investments made with bond proceeds to a yield that is not materially higher than the “arbitrage yield” on the charter school’s bonds. Generally, the arbitrage yield is the discount rate when used to calculate the present value of all principal and interest payments on the bonds that produces an amount equal to the issue price of the bonds with certain adjustments. However, exceptions to yield restriction apply to some bond proceeds during certain periods of time (referred to as “temporary periods”) and for the portion of the bond proceeds held in a “reasonably required reserve or replacement fund” during the life of the bond issue.

Three-Year Temporary Period. The most important temporary period is the three-year temporary period beginning on the date of issuance of the bonds. During this period, no yield restrictions apply to bond proceeds that are used to finance capital improvements or costs of issuing the bonds. This temporary period is applicable if the charter school has reasonable expectations that on the date the bonds are issued: (i) the charter school expects to spend at least 85% of the “net sale proceeds” (generally the proceeds from the sale of the bonds, less any proceeds used to fund a debt service reserve fund) within 3 years from the issuance of the bonds; (ii) the charter school has incurred, or within 6 months after the issuance date, will incur a binding obligation to one or more unrelated parties to spend at least 5% of such proceeds; and (iii) the charter school will spend such proceeds and investments thereon with due diligence.

¹ Section 141(e) of the Internal Revenue Code provides 7 categories of permissible private activity bonds.

Thirteen-Month Temporary Period. A second key temporary period is the thirteen-month temporary period for amounts deposited in a “bona fide debt service fund”, generally a fund used primarily to achieve a proper matching of revenues and debt service each bond year by depositing revenues in the fund until they are needed to pay debt service.

Reasonably Required Reserve Fund. A debt service reserve fund is eligible to be invested without regard to yield if the fund is considered “reasonably required” under the Internal Revenue Code, and the size is limited to the least of (i) 10% of the proceeds of the bonds, (ii) the maximum annual debt service on the bonds, and (iii) 125% of average annual debt service on the bonds. The charter school’s financial advisor typically certifies that the reserve fund is reasonably required.

2. Rebate Requirement.

Even if a charter school is permitted to invest its bond proceeds at a higher rate of return than the arbitrage yield, separate rules (the “rebate rules”) determine whether the charter school can keep the investment earnings in excess of the arbitrage yield. An issuer may not retain such excess arbitrage earnings unless it meets an exception provided in the Internal Revenue Code. Thus, while certain exceptions to yield restriction permit bond proceeds to be invested at an unrestricted yield during certain times or when held in certain funds, the rebate requirement generally requires that arbitrage earnings ultimately be paid to the federal government.

Rebate Exceptions. Two categories of exceptions to the rebate requirement applicable to a charter school’s qualified 501(c)(3) bonds are: (i) the bona fide debt service fund exception and (ii) three spending exceptions, including the six-month spending exception, the eighteen-month spending exception, and the two-year construction expenditure exception. A “small issuer exception” exists but is not applicable to qualified 501(c)(3) bonds.

Bona Fide Debt Service Fund Rebate Exception. Amounts earned on a bona fide debt service fund are not taken into account if the gross earnings on such fund are less than \$100,000 for the bond year, and no dollar limitation applies to other bonds (except private activity bonds) if the average maturity of the bond issue is at least 5 years and the bonds are fixed-rate bonds for the entire term they are outstanding.

Spending Exceptions to Rebate. One of three spending exceptions to rebate may apply if the charter school spends all of the proceeds of the bonds within prescribed time periods. These exceptions are based on actual expenditures of the bond proceeds and the expected investment earnings thereon. The spending exceptions do not apply to amounts held in a reasonably required reserve fund which remain subject to the normal rebate requirement.

Yield Reduction Payments. For bond proceeds that are not eligible, or are no longer eligible, for a temporary period, yield reduction payments may be available to reduce the yield on the investments. Only certain classes of bond proceeds qualify for yield reduction payments, including (i) those that initially qualified for one of the temporary periods described above that has expired, (ii) amounts held in a reasonably required reserve fund but exceed the prescribed limits described in this chapter, and (iii) certain types of bond proceeds arising in refundings.

Rebate Compliance Provider. Because of the technical requirements and complexities involved in rebate calculations, a charter school should consider engaging an expert to provide rebate (and penalty) calculation services for its debt financings. BLX, a subsidiary of Orrick, Herrington and Sutcliffe LLP, offers full rebate compliance services on a cost-effective basis. For further information regarding BLX, contact a member of Orrick Charter School Finance Group listed on the inside back cover of this booklet.

3. Hedge Bond Restrictions.

The Internal Revenue Code generally prohibits tax-exempt bonds from being issued too far in advance of the time the proceeds are expected to be used to construct or acquire the assets to be financed. However, under certain circumstances, charter schools may be interested in issuing bonds at the earliest opportunity, particularly when interest rates are expected to rise. In general, interest on the bonds will not be tax-exempt unless the charter school reasonably expects to spend at least 85% of the net sale proceeds (generally the proceeds from the sale of the bonds, less any proceeds used to fund a debt service reserve fund) within 3 years of the issue date of the bonds and does not invest more than 50% of the bond proceeds in investments with a guaranteed yield for 4 or more years.

4. Overburdening Restrictions.

Charter schools should be aware that the Internal Revenue Code prohibits bond issues that “overburden” the tax-exempt bond market, such as issuing more bonds, issuing bonds earlier, and allowing bonds to remain outstanding longer than is otherwise reasonably necessary to accomplish the governmental purposes of the bonds. This analysis mostly depends on whether the primary purpose of the transaction is a bona fide purpose and whether the bonds would have been issued if interest on the bonds was not tax-exempt. Bonds with a weighted average maturity of more than 120% of the average reasonably expected economic life of the financed assets and bonds that do not qualify for any expenditure-related temporary periods may indicate overburdening. Facts and circumstances may outweigh these factors.

5. Reimbursement Financings.

The rebate requirement applies to limit the return on the investment of unexpended bond proceeds. The most common way to expend bond proceeds quickly is through a reimbursement financing where bond proceeds are used to reimburse the charter school for project costs previously paid from its other funds. Reimbursement financings are subject to additional requirements and are described in more detail in section C of Chapter 4 of this booklet.

B. QUALIFIED 501(C)(3) BOND REQUIREMENTS

As previously stated, most tax-exempt bonds issued to benefit charter schools are issued as “qualified 501(c)(3) bonds,” a category of private activity bonds issued pursuant to Section 145 of the Internal Revenue Code that are available to organizations exempt from federal income taxation pursuant to Section 501(c)(3) of the Internal Revenue Code (“501(c)(3) organizations”). Generally, a bond qualifies as a qualified 501(c)(3) bond if the 501(c)(3) organization (in this case, the charter school) owns the financed facility and uses it to conduct its exempt activities. The private business tests are applied to 501(c)(3) bonds using a 5 percent limit rather than the 10 percent limit applied to governmental tax-exempt bonds. Several other requirements specific to private activity bonds apply to qualified 501(c)(3) bonds that do not apply to governmental bonds.

As explained below, the law related to governmental status of organizations, such as a public charter school, is evolving currently. Public charter schools may

be able to benefit from the issuance of governmental bonds in the future. But, for now, Orrick believes the best approach is that a public charter school file for federal tax exemption under Section 501(c)(3) of the Internal Revenue Code and issue tax-exempt bonds as qualified 501(c)(3) bonds.

1. Government Instrumentality vs. 501(c)(3) Organization.

As previously mentioned, the discussion in this booklet generally assumes that tax-exempt bonds issued to finance public charter school facilities will be issued as qualified 501(c)(3) bonds. Almost every nonprofit charter school is organized as a 501(c)(3) organization, as are most charter management organizations (CMOs) and other related entities. Issuance of qualified 501(c)(3) bonds involves procedural requirements and limitations that are not applicable to governmental bonds, including for example, the requirement for a public hearing and the 2% limit on proceeds used to pay costs of issuance. For these reasons and because charter schools are public schools, it is fair to consider whether a charter school is a governmental entity for this purpose, and therefore, whether the tax-exempt bonds issued for charter school facilities can be governmental purpose bonds as opposed to the more restrictive qualified 501(c)(3) bonds.

The tax analysis for determining whether a charter school is a governmental entity (the term typically used is “instrumentality”) is complicated for two reasons. First, the IRS has established different tests for determining instrumentality status depending on whether the question is analyzed for tax-exempt financing purposes, public pension plan purposes, excise tax purposes, etc. Most of the discussion in recent years has focused on whether charter schools are instrumentalities for public pension plan purposes.² The IRS generally treats charter schools as instrumentalities for that purpose. Second, the existing test for tax-exempt financing purposes focuses primarily on whether a government unit controls the charter school. Historically, control of a nonprofit organization, such as a charter school, exists if the government unit has the ability to appoint and remove a majority of the governing board of the charter school. On the other hand, IRS private letter rulings, again mainly in the public pension plan space, conclude that the chartering process, together with state funding and regulatory oversight, for a charter school meets the control requirement.

² See IRS Notice 2015-7, 2015-6 I.R.B. 585.

However, every state has different rules and regulations making it difficult to apply this guidance across the states. Helpful guidance from the Internal Revenue Service for tax-exempt financing purposes has yet to be provided for charter schools. Generally, it is Orrick's current view that charter school transactions should be undertaken using qualified 501(c)(3) bonds. Importantly, even if the charter school qualifies as a government instrumentality, the bonds may be required to be issued as qualified 501(c)(3) bonds if the bond-financed project is managed by a CMO or if the proceeds are loaned to a related property owner and leased to the charter school.

2. Ownership of Financed Facilities.

Federal tax law requires that all property financed with the proceeds of a charter school's qualified 501(c)(3) bonds must be owned by the charter school, another 501(c)(3) organization or a state or local governmental unit.³ Alternate structures can provide some flexibility while meeting this ownership requirement.

Long-term ground leases may be an acceptable alternative to formal ownership. For example, a charter school could enter into a long-term ground lease of land owned by a non-exempt entity and use proceeds of tax-exempt bonds to construct its facility on this land. In this circumstance, the term of the ground lease must be long enough to cause the bond-financed facility to be owned by the charter school for federal tax purposes. Generally, this requires the term of the ground lease to be substantially longer than the reasonably expected economic life of the financed project. In practice, the terms of the ground lease are often longer and may include one or more options to renew the lease based on the circumstances.

Another common structure for charter school financings involves the lease of an existing structure and the use of tax-exempt bond proceeds solely to finance certain tenant improvements required for the charter school's educational activities. In these situations, in order to meet the ownership requirement, unless the tenant improvements are of a type that reasonably can be removed by the charter school and used elsewhere, (such as, moveable partitions, equipment, or furniture), similar to the ground lease, the term of the lease cannot end prior to the end of the expected economic life of the financed improvements, is often longer, and may include one or more renewal options.

³ Section 145(a) of the Internal Revenue Code.

3. Use of Financed Facilities.

In addition to the requirement that all property financed with proceeds of the bonds must be owned by the charter school, at least 95% of the net proceeds of the bonds must be used to finance qualified project costs. Use by the charter school for activities that constitute an unrelated trade or business use is counted as part of the 5% non-qualified use (including use of proceeds to pay costs of issuance up to the 2% limit). Nevertheless, the project or portions of it may be used by non-exempt entities in their trade or business if (i) the portion of the project so used can be allocable to moneys spent on the project from sources other than proceeds of tax-exempt bonds (such as accumulated funds, donations, or proceeds of taxable debt);⁴ (ii) as stated above, the portion of the project so used represents less than 5% of proceeds of the tax-exempt bonds (net of reserves), with any proceeds (up to the 2% cap) used to pay costs of issuance counted against this 5% amount; or (iii) the use by a non-exempt entity is pursuant to an operating or management contract that meets the requirements of a qualified management contract.⁵

4. Financing Costs of Issuance.

Costs of issuance may be financed with proceeds of qualified 501(c)(3) bonds subject to a cap of 2% of the sale proceeds of the bonds. This 2% counts against the 5% otherwise permitted for non-qualified costs. If this amount is insufficient to cover all issuance costs of the bonds, the charter school may use equity or proceeds of a taxable borrowing to cover the issuance costs in excess of the 2% limit.

5. Public Hearing and Governmental Approval.

Qualified 501(c)(3) bonds must be approved by the governmental issuer of the bonds and, if different from the governmental issuer, governmental entities with jurisdiction over the site(s) where the bond financed property will be located. This approval must occur after a public hearing held in the jurisdiction providing approval and prior to the issuance of the bonds. The public hearing is often referred to as the "TEFRA Hearing" based on the name of the tax legislation requiring such hearing.⁶ Public notice of such hearing must be published at least 7 days prior to the date of the TEFRA Hearing using one of several

⁴ See, Chapter 5 "Interplay Between Bonds and Fund-raising".

⁵ See subsection 7 for a discussion of IRS Revenue Procedure 2017-13 regarding the requirements for a qualified management contract.

permitted methods. Publication in a newspaper of general circulation in the approving jurisdiction and/or publication on the approving jurisdiction's website are currently the most common method used. Once the public hearing has occurred, the governmental unit must approve the issuance of the bonds. Approval can take several forms, but typically consists of approval by the applicable elected official of the governmental unit or its elected legislative body.

6. \$150 Million Limitation.

In some circumstances, a 501(c)(3) organization cannot benefit from more than \$150 million of outstanding qualified 501(c)(3) bonds that are not "qualified hospital bonds" (95% or more of the net proceeds used for a hospital). Because charter school bonds do not meet the requirements of qualified hospital bonds, this \$150 million limitation must be taken into account. This limitation was repealed for capital project bonds issued after August 5, 1997, as long as at least 95% of the net proceeds of such bonds are used to finance capital expenditures incurred after that date. In other words, the \$150 million limitation may apply to bonds issued to finance charter schools if the bonds also finance working capital expenditures, including otherwise permissible post-construction funded interest on the bonds, exceeding 5% of the net proceeds of the bonds. Organizations under common management and control are treated as one entity for purposes of this limitation; thus, large charter school networks and CMO's must monitor their working capital expenditures financed with qualified 501(c)(3) bond proceeds to ensure compliance with this exception to the \$150 million limitation.

7. Contracts with Private Managers, Operators and Other Service Providers.

A management or service contract can result in private business use of a tax-exempt bond-financed facility. The IRS has provided a safe harbor, and satisfying the safe harbor requirements means these contracts will not cause private business use of the financed project.

Qualified Management Contracts Rules — *Safe Harbor Requirements*. Key components of the safe harbor for qualified management contracts are set forth below.⁷

⁶ Tax Equity and Fiscal Responsibility Act of 1982.

⁷ IRS Revenue Procedure 2017-13, 2017-16 I.R.B. 787.

Reasonable Fee. The fee paid to the service provider must be reasonable.

No Net Profits or Net Losses. Compensation to the service provider cannot be based, even in part, on the net profits or net losses of the financed project.

Term Limitation. The term of the services contract may not be longer than 30 years or if shorter, 80% of the remaining useful life of the project.

Control. The project owner must exercise control over the project, including approval of the annual operating budget, capital expenditures, disposition of property, the rates charged for the use of the project, and the general nature and type of use of the project.

Risk of Loss. The service provider cannot be responsible for replacing the project if there is a catastrophic loss; however, it can obtain adequate insurance as long as this cost is reimbursed by the charter school.

Service Provider Tax Position. The contract must state that the service provider will not claim any depreciation or amortization deduction, investment tax credit, or deduction for any payment as rent with respect to the financed project.

Limitation on Rights. Finally, the service provider must not have a role or relationship with the borrower that as a practical matter would limit the borrower's rights to take action under the contract.

Excluded Incidental Services. Contracts for ancillary or incidental services (routine repair and maintenance contracts, for example) are not considered to be service contracts and therefore do not cause the service provider to be a private business user even if the term of the contract is longer than 30 years.

CMO's and Management Contracts. CMO's are created to manage an association of charter schools and typically qualify as a 501(c)(3) organization. CMO's have significant control over the activities and funding of the individual charter schools; thus, management contracts between charter schools and CMO's often are not qualified management contracts because the contract cannot satisfy the "Limitation of Rights" requirement set forth above. In this circumstance,

it is important that the CMO's status as a 501(c)(3) organization be confirmed before the charter school's bonds are issued and while they remain outstanding.

8. Change of Use or Disposition of Tax-Exempt Financed Facilities.

If the charter school takes a deliberate action that changes the use of bond-financed property or disposes of it while the qualified 501(c)(3) bonds are outstanding, and the change in use or disposition causes the bonds to fail to comply with applicable federal tax law, it must take one of the remedial actions permitted by the Regulations in order to preserve the tax-exempt status of interest on its bonds. If a change in use or disposition of bond-financed property occurs or is being considered, the charter school should contact bond counsel immediately to discuss the remedial actions available to it.

9. Qualified Tax-Exempt Obligations ("Bank Qualified").

Governmental bonds and bonds issued to provide financing for a 501(c)(3) organization may be eligible for "qualified tax-exempt obligation" status (also referred to as "bank qualified" status).⁸ With respect to qualified 501(c)(3) bonds, this status is based on the eligibility of the conduit issuer of the bonds. The conduit issuer (i) must reasonably expect to issue no more than \$10 million of tax-exempt obligations (excluding private activity bonds, other than qualified 501(c)(3) bonds) during the current calendar year, and (ii) must specifically designate the bonds as qualified tax-exempt obligations. This status permits banks and other financial institutions to deduct that portion of their interest expense that is related to ownership of tax-exempt bonds. Bank qualified bonds are attractive to smaller charter schools and CMO's because they are typically issued at lower interest rates. Many private placements of charter school debt are issued as bank qualified obligations.⁹

C. 501(C)(3) ORGANIZATION STATUS

Most charter school bonds are issued as qualified 501(c)(3) bonds, and the tax exemption of these bonds is dependent on the initial and continuing tax-exempt status of the charter school pursuant to Section 501(c)(3) of the Internal Revenue Code. In the context of qualified 501(c)(3) bonds, typically,

⁸ Section 265(b) of the Internal Revenue Code.

⁹ See the Afterword of this booklet "Bank Loans and Direct Placements" for information regarding private placements.

bond counsel and borrower's counsel will require that the charter school complete a tax due diligence questionnaire. The information provided by the charter school in response to the questionnaire is critical to the determination that the charter school's activities comply with the requirements for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code. As part of the questionnaire, bond counsel will request copies of certain documents, IRS filings and other information important to the tax-exempt status of the charter school.

1. Key Corporate Documents.

It is important for a tax-exempt organization to be able to provide copies of certain key documents, including its articles or certificate of incorporation, its bylaws, IRS Form 1023 (Application for Exemption),¹⁰ the IRS determination letter declaring the charter school's tax-exempt status and IRS Form 990 for each of the past three-to-five years, depending on the circumstances.

2. Board of Directors Composition (Founders, Friends and Family).

Many charter schools are an outgrowth of a school created by a church, a community, or a like-minded group of individuals who wish to provide a particular educational environment for students. Upon conversion to a charter school, the board of directors may consist of interested parties related to the original school, including family members, friends, church members, and others. The charter school should review the composition of its board of directors, and if necessary, diversify the board to include individuals who represent the public served by the charter school and who are well-qualified for the responsibilities of managing its operations.

3. Conflicts of Interest with Contractors and Vendors.

Often charter schools in their infancy have relationships with the contractors and other services providers which may present conflicts of interest because a member of the board of directors or a family member of a director has an ownership or financial interest in the service provider. While generally these relationships are not forbidden, the charter school must confirm that the compensation paid to these contractors and service providers reflects the fair market value of the

¹⁰ A charter school may file IRS Form 4506-A to request a copy of its IRS Form 1023, IRS determination letter and IRS Form 990, if these documents cannot be located.

services rendered and that the contracts do not constitute private business use.¹¹ The board of directors should consider and approve these contracts, and a director with a conflict should recuse herself or himself from the consideration and approval. Such action should be properly documented.

4. Board of Directors' Approval and Documentation of Key Matters.

Important matters of the charter school must be reviewed, approved and documented by the board of directors. Examples of these matters include, but are not limited to (i) the amendment of its articles and bylaws, (ii) election of its officers and directors, (iii) termination and replacement of directors, (iv) employment and compensation of executive personnel, (v) adoption of an annual budget, (vi) investment of its funds, (vii) adoption of corporate policies and long-term plans, (viii) compliance with state and federal reporting requirements (i.e., IRS Form 990), (ix) corporate borrowings, and (x) sales, leases, or other dispositions of its property.

5. IRS Form 990 and Schedule K.

Organizations that are exempt under Section 501(c)(3) of the Internal Revenue Code annually must file IRS Form 990 (Return of Organization Exempt From Income Tax). Failure to timely file IRS Form 990 can result in significant penalties and possible revocation of the organization's tax-exempt status. Completion of IRS Form 990 – Schedule K (Supplemental Information on Tax-Exempt Bonds) is required for most tax-exempt organizations with outstanding tax-exempt obligations. Schedule K solicits information regarding the organization's tax-exempt bonds and the bond-financed property. Because the IRS may use information provided on Schedule K to select qualified tax-exempt bonds for audit, careful completion of Schedule K is critical. The charter school should contact qualified tax counsel if it has any questions or concerns about the information to be provided on Schedule K.

If you have additional questions or concerns regarding the federal tax rules applicable to a charter school's tax-exempt financing or the tax-exempt status of your charter school, please contact one of the members of the Orrick Charter School Finance Group who are listed on the inside back cover page of this booklet.

¹¹ See subsection B.7. of this chapter - Contracts with Private Managers, Operators and Other Service Providers.

CHAPTER 14

Post-Issuance Compliance

A Long-Term Responsibility

Public charter schools are responsible for monitoring post-issuance compliance with respect to a range of matters relating to both the investment and expenditure of bond proceeds and the property and programs financed with tax-exempt bonds. As further described herein, these responsibilities apply over the entire life of the obligations, including any refunding bonds.

What Kinds of Responsibilities Do Issuers and Conduit Borrowers Have After Bonds Are Issued?

In addition to the obvious, which is paying the debt service on the bonds, there are a variety of crucial post-issuance responsibilities that public charter schools must fulfill. Failure to perform these duties could lead to serious consequences. The adoption and implementation of written organizational policies and procedures (“PIC Policy”) governing internal compliance with post-issuance obligations helps public charter schools memorialize these responsibilities and ensure long-term success, despite changes in the public charter school which can include normal staff turnover and attrition. Post-issuance responsibilities typically fall into three categories: tax, continuing disclosure, and bond document compliance.

A. TAX RESPONSIBILITIES

In general, when bonds have been issued on a tax-exempt basis, the school will have covenanted in the bond documents (that is, promised to bondholders) that it will not do anything that will cause interest on the bonds to become taxable and that it will take any and all actions necessary to preserve and defend tax-exemption. While the tax requirements are complex, and may vary from bond issue to bond issue, they will be outlined in the tax certificate (the “Tax Certificate”, included in the bond documents) and generally include the following:

1. Expenditure and allocation of bond proceeds.

- Ensuring that bond proceeds are actually spent on qualified tax-exempt bond purposes as detailed in the Tax Certificate.
- Ensuring that bond proceeds are spent within the “temporary period” for investment of bond proceeds, usually three years from issuance. If moneys other than bond proceeds are also to be spent on the project (e.g., equity or taxable financing), a proper and timely allocation of the bond proceeds to qualified tax-exempt bond purposes must be made. In general, this allocation must occur by the later of 18 months from the date the money was spent or from the date the project was completed (or placed in service) and in all events within five years and sixty days from the date the bonds were issued. Proper allocation is critical to ensure and document that bond proceeds are used for qualified purposes and to preserve the tax-exempt status of the bonds, particularly if any portion of the project is intended for use that may not qualify for tax-exempt financing under IRS rules.

2. Investment of bond proceeds.

- Ensuring that bond proceeds are invested in a manner that complies with the bond documents and with the arbitrage rules.
- Ensuring that any earnings resulting from investing bond proceeds or pledged funds at an investment yield in excess of bond yield are rebated to the U.S. Treasury in accordance with applicable tax requirements (except to the extent a specific rebate exception applies).

3. Use of the bond financed project.

- Ensuring that impermissible private use does not occur as a result of arrangements to use the bond-financed project including through:
 - Sale of bond-financed property;
 - Management or service contracts such as cafeteria/food service contracts or contracts with other non-employee specialists that do not meet IRS safe harbor requirements as detailed in IRS Revenue Procedure 2017-13;
 - Leases or subleases of bond financed property, including solar panel and EV charging station leases;

- Short-term use arrangements, such as for summer camps, private events, or weekend use of gym or classrooms, if such use is unrelated to the public charter school's purpose or if all uses pursuant to such arrangement exceed fifty days (per the term of the contract); and
- Other arrangements providing comparable special legal entitlements with respect to bond financed property.
- Making sure that any specific use or program requirements continue to be satisfied (like operating the facility as a public charter school).

4. Other Post-Issuance Tax Compliance Responsibilities.

- Adopting written PIC Policies outlining responsibility to monitor compliance with applicable tax rules.
- Designating specific staff positions as responsible for monitoring post-issuance tax compliance.
- Providing staff involved with post-issuance tax compliance appropriate educational opportunities and training (available through bond counsel, professional associations or IRS outreach programs).
- Maintaining detailed records with respect to expenditure of proceeds, final allocations of bond proceeds to expenditures, arbitrage and rebate compliance (including installment arbitrage analyses) and use of bond-financed property for as long as such bonds (or refunding bonds) are outstanding, plus three years.
- For public charter schools organized as 501(c)(3) organizations, timely filing Schedule K of the IRS Form 990.

5. Inquiries from the IRS.

During the last few years, the IRS has significantly stepped up enforcement of the tax rules pertaining to tax-exempt bonds, resulting in increased probability of receiving inquiries for information from the IRS and possibly an audit challenging the tax exemption of the bonds. It is necessary not only to have comprehensive and accurate records, as noted above, but also to get good advice in responding to even the

simplest of IRS inquiries. Copies of a pamphlet prepared by the tax department of Orrick, Herrington & Sutcliffe LLP, "An Introduction to IRS Audits of Tax-Exempt Bonds" are available upon request. In recent years, IRS officials have repeatedly emphasized the importance of implementing post-issuance tax compliance programs. Public charter schools that have effective post-issuance compliance procedures are significantly more likely to respond to an IRS audit both successfully and cost-effectively.

B. DISCLOSURE RESPONSIBILITIES

The school will have executed a Continuing Disclosure Certificate or Agreement obligating it to:¹

- Provide to the Municipal Securities Rulemaking Board's Electronic Municipal Market Access system ("EMMA") certain financial and operating information on a periodic basis (typically quarterly).
- Provide immediate notice to EMMA of the occurrence of certain specific events listed in the Continuing Disclosure Certificate.
- In certain transactions, conduct investor information conference calls on a periodic basis (e.g., semi-annually) to review financial and operating information.²

Like the IRS, the Securities and Exchange Commission ("SEC") has significantly increased its enforcement activity in the municipal bond area. This has led to increased requests for information and some very serious enforcement actions. As with IRS inquiries, good legal advice is needed before responding to even an informal inquiry from the SEC.

C. BOND DOCUMENT RESPONSIBILITIES

The bond documents themselves (not only the indenture and loan agreement, but any credit provider agreement, investment agreement, or swap agreement) contain a number of responsibilities of the school in

¹ If the bonds are issued in authorized denominations of \$100,000 or more, and are sold to qualified purchasers by private placement (or may be tendered at par at least as frequently as every nine months), they are exempt from SEC Rule 15c2-12, which requires the charter school to undertake the obligations described in this paragraph. However, even when the exemption applies, charter schools will typically take on such responsibilities anyway in order to satisfy the requirements of bond investors.

² Direct communications with investors should be undertaken carefully, in order to comply with the basic concept that no material nonpublic information be provided to any one or small group of investors without also making such information available to the entire marketplace (e.g., through posting on EMMA).

addition to timely payment of debt service. These requirements will vary widely depending on the type of bonds, source of security and payment, credit enhancement, and the like. Typical examples include:

- Providing audited financial statements by a certain date.
- Providing other specified information periodically or upon the occurrence of certain events to bond holders, rating agencies, credit enhancement or liquidity providers, and swap providers.
- Compliance with a debt service coverage test.
- Compliance with other financial tests (including a cash-on-hand test).
- In case of general fund pledges by conduit borrowers of their non-trustee held general funds, making sure all general funds are deposited in the pledged account.
- Periodically renewing UCC or other filings.
- Maintenance and periodic certification of casualty and other insurance.

What Are the Consequences of Failure to Perform Post-Issuance Responsibilities?

A. TAX RESPONSIBILITIES

Failure to perform these responsibilities could lead to the bonds being declared taxable or to substantial payment to the IRS to close its audit without declaring the bonds taxable, following a painful, time consuming and expensive audit process. Either result mentioned could lead to a SEC investigation and enforcement actions based on the premise that the official statement for the bonds had failed to properly disclose the tax risk. A declaration of taxability would also likely lead to lawsuits from bondholders.

B. DISCLOSURE RESPONSIBILITIES.

Failure to provide the Annual Report or Special Events Notices in accordance with and by the time agreed in the Continuing Disclosure Certificate would result in the school having to disclose such failure in its official statements for the next five years. Disclosing information that is either inaccurate or

incomplete in a way that would be material to investors, in light of the circumstances under which these disclosures are made, could lead to investor lawsuits or SEC action for securities fraud under Rule 10b-5.

C. BOND DOCUMENT RESPONSIBILITIES

Failure to comply with covenants in the bond documents normally would constitute a default under the documents and could lead to a declaration of an Event of Default and consequent remedies, including the involvement of a special third-party consultant guiding a review and reform of the school's operations or, in some cases, a declaration that the entire principal amount of bonds become immediately due and payable. Even without a declaration of Event of Default, bond document defaults may be required to be disclosed in audited financial statements or to rating agencies or credit providers. It may also affect the ability to issue additional bonds under the terms of the bond covenants.

As described above in Chapter 12 "Steps to Issuing the Bonds and the Finance Team", professional assistance in complying with the post-issuance responsibilities is available through rebate analysts and other compliance monitoring consultants. Public charter schools that issue tax-exempt bonds should retain such services in order to ensure compliance over the relevant period of time, as it is likely the tenure of the staff and board of the charter school who were involved in the issuance of the bonds will not outlast the tenure of the bonds themselves. Even large sophisticated CMOs should review the need to retain such services.

CHAPTER 15

SEC Enforcement

As previously discussed in Chapter 10, charter school bonds are “securities” for purposes of the Securities Act and the Exchange Act and consequently are subject to certain securities laws concerning disclosure of material information to potential investors. As such, charter schools and their bonds, as well as financing participants, are subject to oversight by the SEC, the MSRB, and the IRS, the regulatory agencies in the municipal bond arena. All market participants, including charter schools, are held accountable under the securities and tax laws.

While enforcement activity by the SEC has occurred for many years, there has been a marked increase in the SEC’s focus on the municipal market since 2010 due to the formation of the Public Finance Abuse Unit (formerly called the Municipal Securities and Public Pensions Unit) in the Enforcement Division. This Unit has professionals located in SEC Regional Offices around the country, including attorneys, accountants, and investigators, many of whom are former prosecutors. These professionals have taken their role seriously, and all participants in the municipal market, including borrowers (such as charter school operators), issuers, underwriters, municipal advisers, attorneys, and consultants, have been the targets of enforcement actions. In recent years, the SEC has brought a significant number of enforcement actions specifically targeting entities and individuals that provide advisory and consulting services to charter schools in connection with municipal bond offerings.

Historically, many of these enforcement actions claimed that the anti-fraud provisions of the federal securities laws (Sections 17(a)(2) and (3) of the Securities Act of 1933, and Section 10(b) and Rule 10b-5 under the Securities Exchange Act of 1934) had been violated. These anti-fraud provisions require that the information provided in connection with the offer or sale of securities must not contain any untrue statement of a material fact and must not omit to state a material fact necessary to make such information not misleading. In particular, these claims have included the following:

- Failure to disclose prior violations of continuing disclosure obligations,
- Misleading or incomplete disclosures about financial condition,
- Failure to disclose the use of unusual accounting practices,
- Failure to disclose shortcomings in risky economic development projects, and
- Failure to disclose other material financial or legal risks.

In 2014, the SEC brought an enforcement action against a charter school operator for failing to disclose conflicts of interest in an official statement. The operator had not disclosed that family members of senior management engaged in transactions with the operator, violating conflict-of-interest prohibitions in grant agreements with the State of Illinois. Because these grants were critical to sustaining the charter school's operations and the operator's ability to repay the bonds, the undisclosed conflicts posed a material risk. The SEC also brought charges against the operator's President and CEO. In settling with the SEC, the operator agreed to improve its internal procedures and training, including appointing an independent monitor, while the President and CEO agreed to pay a \$10,000 penalty and were barred from participating in future municipal bond offerings.¹

In 2016, the SEC settled an enforcement action against a Pennsylvania charter school for materially misstating its compliance with a continuing disclosure agreement in an official statement. The charter school had represented that it complied in all material respects with a prior continuing disclosure agreement when, in fact, it had filed its audited financial reports late by periods ranging from two to 28 months. The charter school self-reported this violation under the SEC's Municipalities Continuing Disclosure Cooperation Initiative and, as part of the settlement, agreed to establish written policies and procedures and periodic training regarding continuing disclosure obligations, and to disclose the settlement terms in any future official statements.²

As discussed more fully in Chapter 10, charter schools offering bonds to the public must comply with the SEC's disclosure framework, which centers on the preparation and dissemination of an official statement that is accurate and complete in all material respects. The anti-fraud provisions of the federal securities laws apply not only to the initial official statement but also to any

¹ UNO Charter School Network, Inc., IL, Rel. No. 34-73841, 2014.

² Collegium Charter School, Release No. 10153, 2016.

other communications made in connection with the offer or sale of bonds, including oral statements by school representatives. In addition, SEC Rule 15c2-12 requires underwriters to obtain a commitment from the charter school to provide continuing disclosure, including annual financial and operating information and timely notice of material events, filed with the MSRB's Electronic Municipal Market Access (EMMA) system for the entire life of the bond issue. Importantly, charter schools bear primary liability for any material misstatements or omissions regarding their operations or finances in offering documents, and this liability cannot be transferred to the underwriter, bond counsel, or other financing team members. The threshold for adequate disclosure is the concept of materiality: information is deemed material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. Given the SEC's active enforcement posture, charter schools should work closely with experienced disclosure counsel to ensure that both their initial offering documents and their ongoing continuing disclosure filings meet these standards.

In 2020, the SEC charged the CEO and Director of Finance of a charter school operator with misleading investors through an offering document that failed to disclose serious cash flow problems, delinquent vendor payments, an overdue private term loan, and a fully drawn bank line of credit. The document also contained misleading financial projections. Both individuals agreed to injunctions barring them from participating in future municipal debt offerings and to pay civil penalties.³

It is important to point out that the SEC (as distinct from a private plaintiff) does not have to prove that an alleged disclosure violation or failure resulted in any bond default, loss of value, or financial harm to any investors. Rather, it just has to prove that the violation or failure occurred. The SEC can even base its claim on statements made by an issuer or obligor and its representatives either orally or in other reports or documents other than an official statement. In addition, as demonstrated in the case above, the SEC can fine individuals and bar them from participating in the industry.

Even if the SEC does not end up bringing charges, the consequences of an SEC investigation can be very expensive and harmful to defend. Moreover, SEC investigations and charges result in bad publicity, political damage, and possible reductions in ratings or other financial market consequences.

³ SEC v. William Batchelor and John Zukoski, Litigation Release No. 24806, 2020.

Recent Enforcement Focus: Municipal Advisor Registration, Fiduciary Duties, and MSRB Rules

Since the adoption of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, the SEC has had authority to regulate municipal advisors under Section 15B of the Securities Exchange Act. Final registration rules became effective in July 2014 and require any person that provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities to register as a municipal advisor with the SEC. Charter schools committed by contract or other arrangements to support payment of obligations on municipal securities to be sold in an offering are obligated persons pursuant to the Securities Exchange Act. As a result, firms and individuals that advise charter schools on bond offerings, including on the structure, timing, terms, and selection of financing team members, must be properly registered and must comply with the MSRB rules.

Beginning in 2019 and accelerating through 2026, the SEC has brought numerous enforcement actions against firms and individuals for providing municipal advisory services to charter schools without being registered. These actions have targeted a wide range of participants, including real estate development consultants, financial advisors, capital advisory firms, and business consulting companies, many of which did not consider themselves to be municipal advisors but were found to have crossed the line into providing advice on the issuance of municipal securities. Penalties in these cases have typically included cease-and-desist orders, censures, civil money penalties ranging from \$5,000 to \$100,000, and in some cases disgorgement of fees with “Fair Funds” established for distribution back to harmed charter schools.

Beyond registration violations, the SEC has also pursued enforcement actions against registered municipal advisors that failed to meet their fiduciary and conduct obligations. Under Section 15B(c)(1) of the Exchange Act and MSRB Rule G-42, municipal advisors owe a fiduciary duty to their municipal entity clients (including charter schools) that encompasses a duty of loyalty and a duty of care. This includes the obligation to provide full and fair written disclosure of all material conflicts of interest prior to or upon engaging in municipal advisory activities.

In 2024, the SEC brought an enforcement action against a registered municipal advisor and its managing director for failing to timely and fully disclose material

conflicts of interest in connection with municipal advisory services provided to charter schools. The municipal advisor's affiliate, a registered investment advisor, frequently purchased the bonds that the municipal advisor had advised the charter schools to issue and, in most instances, also served as the compensated bondholder representative. This arrangement created a conflict between the advisor's financial interest in the affiliate's bond purchases and the charter schools' interest in obtaining the lowest possible interest rate. The municipal advisor failed to disclose these conflicts prior to providing advice, and when it did eventually disclose them, the disclosures were inadequate. The SEC also found that the firm's written supervisory procedures were not reasonably designed to achieve compliance with applicable MSRB rules. Penalties included civil money penalties of \$200,000 against the firm and \$75,000 against its managing director, along with cease-and-desist orders and censures.⁴

In 2021, the SEC filed a civil action against a municipal advisory firm and its co-principal for unlawfully engaging in municipal advisory activities with charter school clients before the firm was registered and for entering into a prohibited fee-splitting arrangement with a bank underwriter in violation of MSRB Rule G-42(e). The litigation proceeded to a partial summary judgment ruling in April 2024, in which the court found that the defendants had violated registration requirements, entered into illegal fee-splitting arrangements, and breached fiduciary duties owed to their charter school clients. The court emphasized that agreements to split fees between a municipal advisor and an underwriter are strictly prohibited by MSRB Rule G-42, whether or not disclosed, because they create conflicts of interest that may compromise the advisor's ability to act in the charter school's best interest. A final judgment was entered in October 2024, imposing injunctions, disgorgement, and civil penalties. The case remains active, with the defendants challenging the SEC's subsequent administrative efforts to revoke their municipal advisor registration.⁵

Investment Adviser Misconduct

Charter schools should also be vigilant against investment fraud. In 2023, the SEC settled claims against the founder of an unregistered investment adviser and sued his partner after they convinced a charter school and a real estate fund to each invest \$5 million in what was represented to be government bonds and debt securities but was actually invested in derivative products.

⁴ In the Matter of Hamlin Capital Advisors, LLC and Michael Ferrell Braun, SEC Release No. 34-101424, October 24, 2024.

⁵ Securities and Exchange Commission v. Choice Advisors, LLC and Matthias O'Meara, No. 3:21-cv-01669-JO-MSB (S.D. Cal. filed Sept. 22, 2021).

The founder agreed to pay disgorgement and civil penalties and was barred from association with any investment adviser, broker, dealer, and municipal securities dealer.⁶

The recent wave of SEC enforcement actions carries several important lessons for charter schools contemplating a bond offering or other municipal securities transaction:

Verify your advisors' registration status. Before engaging any firm or individual to assist with a bond offering, charter schools should confirm that the firm is registered with the SEC and the MSRB as a municipal advisor and that its representatives have passed the required MSRB Series 50 qualification examination. Registration information can be verified through the SEC's EDGAR system and the MSRB's website. The SEC has repeatedly demonstrated that it will pursue enforcement actions against unregistered advisors even when the advisory services are bundled with other consulting services such as real estate development, project management, or accounting.

Charter schools should insist that their municipal advisors provide full and fair written disclosure of all material conflicts of interest, including affiliate relationships, fee-splitting arrangements, and any financial incentives that could compromise the advisor's ability to act solely in the school's best interest, prior to or upon the commencement of advisory services. The SEC has made clear that inadequate or untimely disclosure of conflicts constitutes a violation of the advisor's fiduciary duty.

Charter schools participating in a bond transaction must be aware of these securities laws and hire competent counsel, whether it be their own borrower's counsel or special disclosure counsel. Such counsel can assist the school in preparing full, accurate, and timely disclosure and can evaluate whether the advisor's engagement letter and conflict disclosures comply with MSRB rules. In addition, counsel can also help the school with creating policies and procedures aimed at ensuring compliance with the school's ongoing continuing disclosure requirements. Given the SEC's demonstrated willingness to pursue enforcement actions against all participants in the charter school municipal bond market, the engagement of experienced counsel is more important than ever.

⁶ In the Matter of Clark Reiner, Securities Act Release No. 11237, Sept. 19, 2023; SEC v. William E. Miller, Civil Action No. 3:23-cv-01158 (D. Conn. 2023).

CHAPTER 16

Equitable Facilities Fund

About Equitable Facilities Fund

Equitable Facilities Fund, Inc. ("EFF") is a nonprofit 501(c)(3) social impact fund established in 2017 to provide high-performing public charter schools with equitable access to low-cost, long-term financing. EFF operates through Equitable School Revolving Fund, LLC ("ESRF"), a bankruptcy-remote financing entity that issues bonds and manages its loan portfolio. The EFF loan program is intended to position public charter schools on a more equitable footing with traditional public-school districts in their ability to finance facilities and other capital assets.

EFF was formed by charitable organizations active in the public charter school sector to address a persistent affordability crisis facing charter schools. As described in Chapter 1, unlike traditional public-school districts, which can access tax-exempt financing secured by local property taxes, charter schools lack this dedicated security and consequently face higher borrowing costs, less favorable terms, and uncertain market access. To deliver lower cost capital to public charter schools, EFF's dual objectives are: (i) to make the capital market more efficient for public charter school charter bond investors while (ii) enabling high-performing public charter schools to redirect capital savings toward educational programming.

Scale and Impact

Since its inception, EFF has grown into a major lender to public charter schools across the country. As of December 31, 2025, EFF had originated 112 loans totaling approximately \$1.91 billion to 85 unique borrowers. These loans supported approximately 140,000 students across more than 200 schools in 24 states and Washington, D.C.

This growth has been fueled by substantial philanthropic and governmental support. EFF received an initial \$200 million capitalization grant in 2017 from national philanthropists and, by December 2025, had raised approximately \$520 million in total charitable contributions. EFF has also secured over \$70

million in government support from federal and state sources, including grants from the U.S. Department of Education's Charter School Credit Enhancement Program.

A. PROCESS AND STANDARDS

EFF's loan approval proceeds through a multi-stage underwriting process that includes preliminary screening, credit committee review, and full due diligence, that typically spans 12 to 18 months and includes senior leadership team review, two formal credit committee reviews, and final board approval. Each loan application involves one or more site visits, authorizer calls, and multiple management and due diligence calls.

Similar to the credit criteria outlined in Chapters 6 and 7, EFF analyzes each transaction based on five underwriting categories: Educational Program, Financial Health, Regulatory Environment, Market Position, and Project Status. Schools are evaluated on metrics including academic performance, enrollment and waiting lists, financial ratios (such as debt service coverage and days cash on hand), management capacity, and governance quality.

However, unlike most other public charter school lenders or the bond market, EFF places significant weight on the academic performance of students, with the dual premises that: (i) academic growth advances EFF's mission of supporting high quality public charter schools making the greatest impact on underserved communities and students, and (ii) diminishing academic performance provides an early warning system for detecting potentially deteriorating credit conditions and enables early intervention by EFF's asset management team.

B. OUTCOMES AND RESULTS

Comparing then-existing bond market interest rates at the time of each loan closing to the interest rate borrowers obtain on EFF loans, and extrapolating that interest rate differential over the life of each loan, EFF has enabled its public charter school borrowers to redirect toward operational priorities such as staffing, curriculum, and other operational imperatives over \$350 million in interest cost savings as of the publication of this booklet. So long as EFF continues in operation, that figure will increase perpetually, evidencing the powerful effect of the revolving fund model paired with bold philanthropic vision, as contemplated in Version 2 of this booklet. To date, EFF has also

experienced a zero-default record in its loan portfolio, a feat attributable to its high-quality underwriting and active loan monitoring.

The portfolio's academic results demonstrate the quality of EFF's borrower selection. Charter school borrowers in EFF's pool significantly outperform other local and state public schools in both English Language Arts and Math assessments. Based on the Similar Schools Measure (SSM) model developed in partnership with the Charter School Growth Fund, in 2025, EFF portfolio schools achieved results 25 percentage points higher in English Language Arts and 37 percentage points higher in Math compared to other charter schools serving similar student demographics. Further, EFF maintains a strong focus on lending to public charter schools serving students from low-income and underserved communities. It has developed internal practices to maintain high-impact lending across its loan portfolio, with a target to serve at least 70% low-income students.

Looking Ahead

For public charter schools seeking affordable, long-term facilities financing, EFF represents a compelling alternative to standalone bond issuances and conventional financing. By combining philanthropic capital, governmental support, and indirect access to tax-exempt bond markets, EFF has created a model that benefits both borrowers, through lower costs and supportive partnership, and investors, through rigorous underwriting and portfolio management. As the public charter school sector continues to mature, EFF's role as a specialized lender with deep sector expertise positions it as a significant resource for schools committed to high-quality education for underserved communities.

AFTERWORD

Bank Loans and Direct Placements

When used appropriately, bank loans and the direct placement of bonds with banks and other financial institutions can be valuable structuring alternatives to long-term public or limited offering of bonds for charter schools.

Bank loans are often structured as commercial real estate secured transactions and are commonly used by charter schools for the acquisition and/or renovation of school facilities, or the purchase of equipment. Notwithstanding the economic considerations outlined in Chapter 1, this type of financing may be a preferred choice by a charter school (i) as a financing early in a charter school's life cycle when it may not have sufficient operating history to access the bond market, (ii) as a means of bridge financing prior to the issuance of bonds, or in anticipation of receipt of capital campaign moneys or anticipated philanthropic donations, or (iii) as a permanent financing structure with a shorter maturity than the bond market affords.¹ Bank loans are also regularly used as a means of financing working capital.² Without satisfying the additional requirements described below, bank loans are structured as taxable financings for federal income tax purposes.

In some states, Issuers (as described in Chapter 11 "Transaction Structure and Documentation") have the legal authority to enter into loan-structured financings as well as issue bonds on behalf of qualified 501(c)(3) organizations.³ Under such authority, bank loans to charter schools may be facilitated through an Issuer, and to the extent the requirements of the federal tax laws are satisfied, done on a tax-exempt basis. Bank loans documented using this method are not treated as securities and not subject to the disclosure requirements discussed under Chapter 10 "Market Disclosure" and generally have less upfront costs than a publicly offered bond issue.⁴

¹ Three years of audited operations is a common criteria used by rating agencies and bond underwriters and investors to evaluate credit worthiness; Bank loans tend to have maturities of 15 years or less (with some exceptions), while public or limited offering bonds may often mature as long as 30 years.

² Most working capital loans are required to be done on a taxable basis.

³ Texas is an example (see Texas Education Code, Chapter 53A, as amended).

⁴ Costs of issuance vary by transaction.

In addition to a public offering, bonds may also be directly placed with and purchased privately by a bank or other financial institution.⁵ Transactions structured in this way are often internally treated for regulatory and accounting purposes by banks or financial institutions as evidence of a loan. Certain modifications to bonds are consistently required in order to allow for such treatment, but none of such changes are legally or economically detrimental to the charter school.⁶ As with a bank loan structure, bonds structured as a direct purchase or limited offering are typically also exempt from the market disclosure requirements, and all financial and other information is usually required to be delivered directly to the bank or financial institution.

Both bank loans and direct purchase or privately placed bonds may be effective financing tools for charter schools; however, careful consideration should be given when structuring so as to not unduly restrict future borrowings or conflict with any existing debt. As it is often said, when considering any financing, one should always think about the next borrowing. In that regard, a charter school would be well advised to look to its advisors and consultants to ensure that bank loans and direct purchase or privately placed bonds are structured appropriately. Key considerations include: (i) the ability to borrow in the future utilizing long-term bonds, (ii) reasonable prepayment rights, (iii) acceptable and workable additional debt provisions (regardless of structure), (iv) consistency in collateral or security that is pledged to secure any or all debt, and (v) consistency with all covenants (financial and otherwise) and events of default. Conversely, when a charter school is borrowing using a long-term bond issue, careful consideration should equally be given to preserving and maximizing the charter school's rights to access future borrowings using a bank loan and direct purchase or privately placed bond issue.

⁵ In the instance described, there is a single bank or financial institution purchasing the bonds as distinguished for a limited offering of bonds to a small number of accredited investors or qualified institutional buyers (which is more similar to a public offering).

⁶ Some examples: No initial or continuing disclosure requirements, no CUSIP numbers, no ratings, single term bond, denominations no smaller than \$100,000, physical bond certificate (no book-entry), and limited assignability.

ABOUT THE AUTHORS

Eugene H. Clark-Herrera is Chair of Orrick's Charter School Finance Group and has served as bond counsel for public charter schools nationwide in facilities financing transactions for over two decades. Eugene co-founded Equitable Facilities Fund, pioneered capital markets access for California public charter schools, structured several of largest multi-campus public charter school financings to date, and has advised governmental issuers, foundations, advocacy groups and policymakers in the development and expansion of public charter school access to tax-advantaged financing. He is a graduate of Stanford Law School and an alumnus of the Teach for America Corps. He also founded an arts-based youth development organization in the San Francisco Bay Area.

Darrin L. Glymph is Head of the Public Finance team in the Washington, D.C. office. Darrin's practice is primarily transactional, focusing on public finance and legal issues facing state and local governments and instrumentalities. His practice includes representation of issuers or underwriters in long-term and short-term general obligation and revenue bond financings for municipalities, charter schools, educational facilities, and water and power authorities, as well as advising clients on economic development incentives. Darrin is ranked Band 1 in Public Finance by *Chambers USA*.

Amanda Stephens is a partner in the Austin office and has advised on more than \$5 billion of both publicly offered and privately placed charter school financings. Her work on these financings spans across the country, including Texas, Oklahoma, Florida, Tennessee, California, Arizona, and New York, among many others. Amanda works with a first-of-its-kind nonprofit social impact fund that leverages private charter loans to the public market. Since their creation in 2018, Amanda has worked on documenting more than \$1.8 billion in loans to high-performing charter schools that otherwise do not have access to long-term, low-cost financing. Amanda and team work closely with the local borrower's counsel for each new borrower and in each new state to create financing structures that meet the borrower's long-term needs while conforming to state charter law and client lending requirements.

Marc Bauer is a partner in the Los Angeles office, where he advises government bond issuers and nonprofit organizations on complex tax-exempt financing matters. He has extensive experience serving as bond counsel to the California School Finance Authority on multiple bond issuances for nonprofit public charter schools throughout California, including advising on the first issue of Sustainability Bonds for a charter school project. Marc's broader practice includes affordable housing financings, public power revenue bonds, and private university debt issuances, and he provides counsel to both issuer and underwriter clients in transactions involving fixed- and variable-rate obligations, commercial paper, credit enhancement, and revenue bonds. Prior to his legal career, he served as an economics consultant at Deloitte & Touche LLP and Arthur Andersen LLP, and he holds a JD/MBA from the University of Southern California.

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