



Existing Issues for Underwriters: Risks and Rewards

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Role of Bond Rating

- > Assists potential buyers make an informed investment decision
 - Rating provides an independent, objective assessment of a borrower’s capacity to repay financial obligations on a full and timely basis
- > Rating scale is letter based, running from ‘AAA’ to ‘D’
 - Notches within most rating categories denote relative strength within a particular category
 - Most **rated** charter schools are of low investment grade (‘BBB’) credit quality; sector as a whole is still, however, largely non investment grade (‘BB’ category)
- > Rating is a key determinant of borrowing costs
 - Higher rating, lower interest rate
- > Rating facilitates marketability of bond issue
 - Comprehensive credit report helps to “tell the story”
 - Advantageous for both investment grade and non-investment grade issuers



General Comments on Paper: Areas of Agreement

- > Demand for capital to finance permanent charter school facilities far outstrips supply
- > Issue of charter renewal still a major challenge, though increasingly one which can be mitigated
- > Investor concerns related to major industry risks, including limited operating track record; significant debt burden; and illiquidity, are well founded
 - Rated institutions generally have at least two years of operating history; benefit from strong demand; and are financially break-even
 - Financial projections should be crafted around achievable enrollment goals and reasonable estimates of key revenue and expense drivers
- > Management is key to the long-term success of any charter school; succession planning is, therefore, critical
- > Structural enhancements help to build the case for investment grade; however, credit fundamentals must also be in place



General Comments on Paper: A Different Viewpoint

- > Use of charter management organizations (CMO) not a necessarily a strength
 - Unless CMO knows and understands unique attributes of local market, success will be limited
 - Best CMOs employ a flexible operating model which allows individual charter school to tailor the broader philosophy to the local level
- > Intercept mechanisms do not completely eliminate default risk
 - Amount of per pupil funding being intercepted is directly related to a charter school's ability to maintain enrollment
 - An inability to invest and reinvest in programs and facilities will eventually lead to insufficiency of intercepted revenues to pay principal and interest
- > Increase in charter school transaction volume is likely to be tempered by pressured funding mechanisms and more onerous requirements of potential buyers
 - Weakening national economy impacting state and local revenues
 - Investors will demand greater access to timely operating and financial data



Final Thoughts

- > Given the rising rate of inflation, many charter schools will be challenged to prudently manage expenditures over the near to intermediate term
 - Greatest challenge to the operating profile of established institutions
- > For those charter schools which rely upon external philanthropic support to close budget gaps or fund facilities, a challenging economic environment may make this strategy difficult to execute
- > Experienced charter school debt issuers may seek to finance additional facilities to accommodate actual or expected growth
 - Some issuers at or near capacity in existing facilities; others look to build on early success and aggressively expand to new markets
 - Overleveraging is possible, though not probable in most cases
- > As the charter school industry continues to mature, the availability of private sector funding is likely to increase; the public sector will, however, need to play an expanded role to incentivize such investment



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