Education Sector - Charter Schools

Charter schools are alternative public education providers that depend on fixed-period charters from state authorized entities in order to operate and receive ongoing tuition payments. Charter schools are not subject to the same guidelines and regulations as other public schools. Charter schools do not have the ability to levy taxes to generate revenue the way school districts can, leading them to rely on alternative methods for raising funds to complete capital projects.

Many states allow charter schools to issue bonds to raise necessary capital. The number of charter school bond issuances has increased steadily since 2008, as the population attending charter schools has increased nationally from just over 1 million to over 3 million. A greater proportion of recent charter school issuances have been non-rated as compared to prior years. Due to a lack of significant financing history the space can offer yield pickup for investors.

An important component in assessing the long-term durability of a charter school is understanding the political environment at the local and state levels. Unlike typical public schools, charter schools require periodic renewals, typically every 5-10 years, from approved authorizers in order to continue operations. This presents credit risk for a longer duration bond. The difficulty of the authorization process varies between states. Union opposition can also present difficulties for charter schools. As students transfer from standard public school options to charter schools, a fixed dollar amount per-student tuition payment is transferred from the public school districts, leaving general public school options with less capital. In states that are positively predisposed to charters, such political hurdles are less likely to arise. The penetration of charter schools within a state and the friendliness of laws towards charter schools are often indicators of the authorization risk for a particular school.

There are several factors that may make charter schools attractive to parents and students. Charter schools often allow for specialized learning that is more directly tailored to the specific interests and needs of their students in ways that are often unavailable at standard public schools. Charter schools may offer programs for special needs students or for students that do not thrive in a traditional classroom setting. This can make charter schools an attractive alternative for students and parents. Measures of academic performance vary by state but can provide insight into the relative quality of the school. Many parents see charter schools as a safer alternative to other public schools, which may offset the impact that academic performance has on demand. Charter schools can also offer longer school days and more after-school programs, making them an attractive option for working parents or those from areas where extracurricular offerings are lacking. The percentage of students on free lunch can provide insights into the socioeconomic makeup of the student body. Assessing these factors at a particular charter school relative to local alternatives are important factors in accessing enrollment growth projections and durability.

The management of the charter school is another factor to consider. Charter schools that are part of a larger network are typically considered less risky, but often offer lower yields. Stand-alone charter schools that are not part of a larger network are predominantly non-rated issuances, representing a greater proportion of high-yield opportunities. Assessing the ownership structure of a charter school is essential for understanding how the school will be financed. Understanding the relationship and potential conflicts of interest between the developer, manager, and principal parties can help identify potential risks to bondholders.

While these are not the only considerations when deciding the merits of charter school debt, they are significant factors that LCP assesses prior to purchase.