



Charter schools

Investing in innovative education
2021

Charter Schools: Investing in parents' demand for more choices and better school options

Charter schools have been the most enduring and impactful innovation in public education in the last 30 years. City Academy, the very first U.S. charter school, opened its doors to 53 students in 1992. Today, more than 3.3 million students are enrolled in 7,500 charter schools across the nation. Forty-four states, two U.S. territories and Washington, D.C. have laws allowing for the creation of charter schools.¹ At Ecofin, we believe parents' demand for more choices and better school options will continue to fuel the need for disciplined capital investment in high quality charter school facilities.



San Jose Schools (Jacksonville, FL). Ecofin supported this development as a sole investor. Image and investment shown is for illustrative purposes only.

Public Schools: From Idea to Essential

The history of education in the United States is an evolution from a luxury for the children of the wealthy, to a fundamental right for all. In colonial times, it was common for children of prominent families to be taught in the home by private tutors or a parent. America's first public school, The Boston Latin School, was founded to teach boys Greek, Latin and the "elementary subjects" in 1635. Early alumni included Founding Fathers John Hancock, Samuel Adams and Benjamin Franklin.² Following the American Revolution, Thomas Jefferson called for the establishment of a formal educational system funded by tax dollars, but it would be decades before this vision became reality. By the mid-1800s, public schools began to emerge in communities that could afford them. By 1918, all U.S. States had passed laws requiring children to complete elementary school.³ By 1967, public schools had become such an integral part of American life that K-12 public education expenditures accounted for 4.1% of GDP and have remained +/- 0.4% ever since. In 2017, approximately 50,615,000 students were enrolled in over 98,000 K-12 public schools across the nation. That same year, private schools enrolled an additional 5,776,000 K-12 students.⁴

The Quality-Equity-Control Conundrum

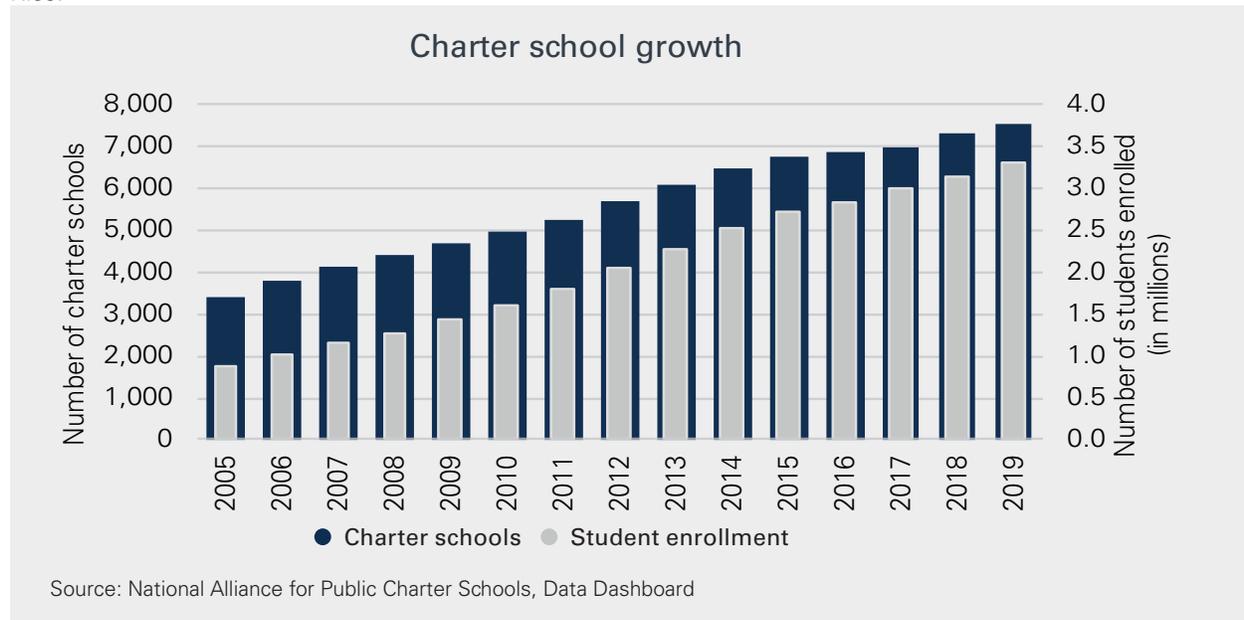
Achieving the American ideal that students of all socioeconomic, racial and ethnic backgrounds have access to a free, quality public education enabling them to achieve their full potential, has proven exceptionally challenging. The quality of the public school a child attends is highly correlated with the wealth of the community in which they reside. Historic boundaries created to ensure tax revenues stay "in" and low-income students are kept "out" of the most desirable public schools have endured through the creation of autonomous school districts. Low population density has limited education offerings available to students in rural communities. Even well-intentioned policies to ensure equitable distribution of resources to underserved communities through federally funded programs in urban communities can spawn unwieldy education bureaucracies that stifle innovation and prevent educators from adequately serving their students. As a result, many students living in wealthy communities have access to a wide variety of excellent public school offerings. For students living in less affluent communities, under-resourced schools focused on simply meeting basic state standards are typically the norm. These systemic failures in public education have prevented millions of children from developing the basic skills necessary to succeed in today's information driven economy.

Parents Demand a Seat at the Table

Moving to a “better” school district or enrolling in a private school has always been an option for families with the means to do so. Historically, families without the financial resources for a private school or the ability to relocate had little or no say as to the public school their child would attend - all decisions fell under the purview of district officials. Frustrated by perpetually underperforming schools and unresponsive education bureaucracies, parents from diverse communities across the nation began organizing and, demanding: 1) better schools; 2) more options; and 3) that parents be empowered to choose the best option for their children. Initially, these demands were ignored; later they were attacked by the education establishment as unrealistic, unworkable and incompatible with public education. By the early 1990’s, however, public support for these principles had achieved critical mass. “School Choice” options, such as magnet schools, vouchers, tax-credit scholarships, inter/intra-district school choice, Advanced Placement, International Baccalaureate and a promising new option known as “charter schools”, were rapidly expanding and gaining popularity.

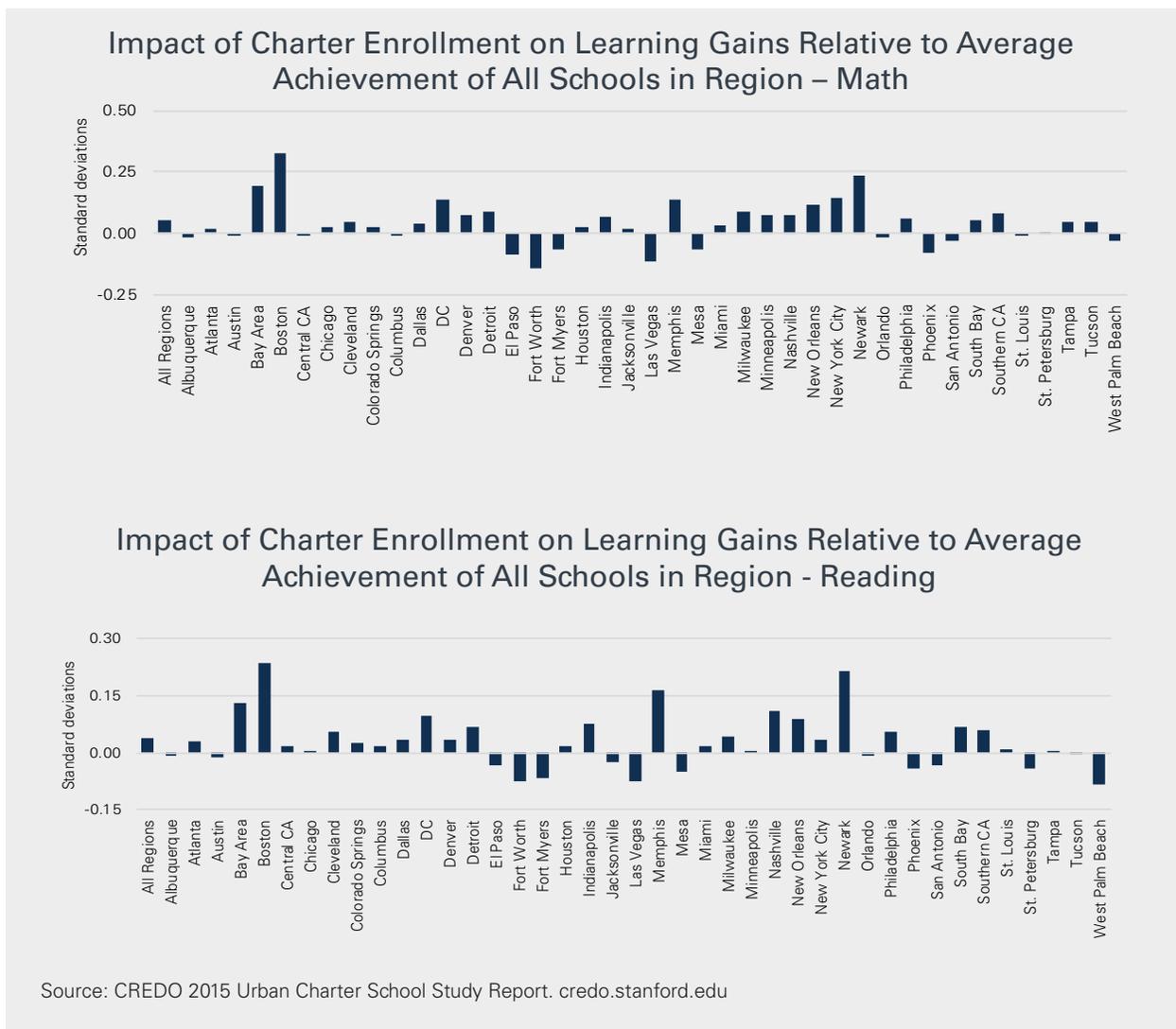
Charter School Emergence & Expansion

In 1988, American Federation of Teachers (AFT) union president, Albert Shanker, outlined his vision for a new kind of publicly funded, independently managed school. He called them “charters” and saw them as educational laboratories, where teachers could try out new pedagogical approaches.⁵ The idea captured the imagination of parents, teachers and politicians on both sides of the aisle. By 1991, Minnesota Governor, Rudy Perpich, had signed the nation’s first charter school law, with 18 states following his lead over the next three years. As of June 30, 2019, there were 7,533 charter schools serving 3,317,512 students across 44 states, Washington D.C., Guam and Puerto Rico.



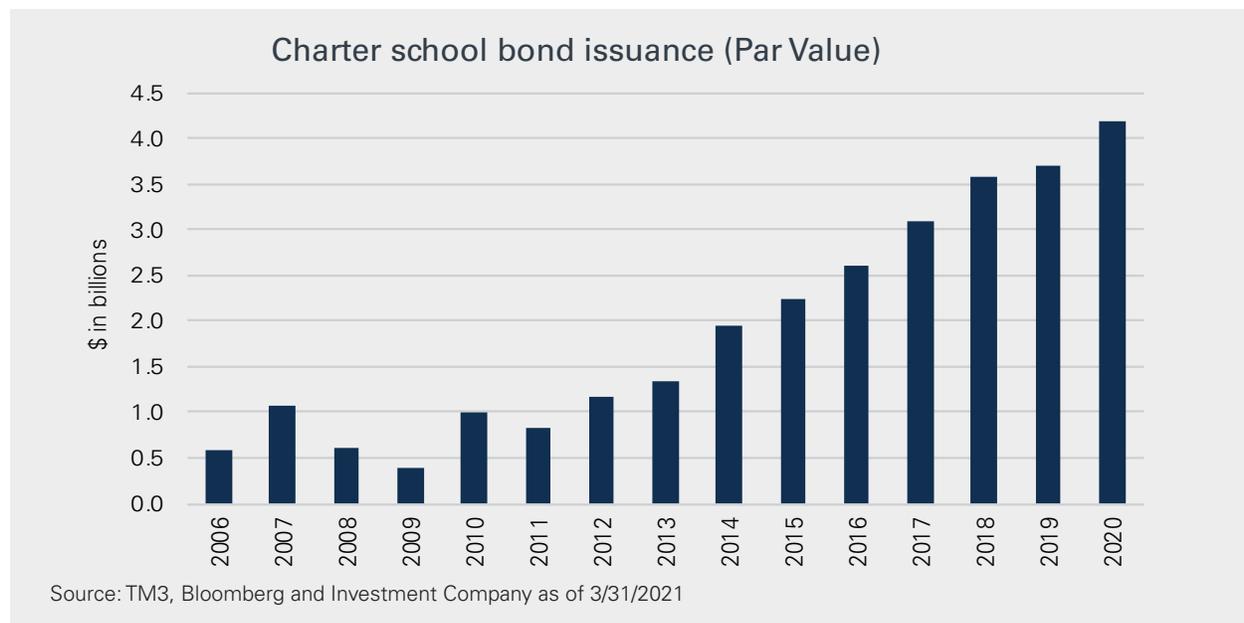
Charter Schools: Autonomy in Exchange for Accountability

It is important to understand that **charter schools are public schools** that operate under the control of a not-for-profit board rather than a school district. Charter schools are required to serve any eligible public school student. They exist to provide an alternative when district public schools are either failing or parents feel they are not providing their children with adequate education opportunities. Charter schools may not have any form of admissions testing and must admit student via lottery when enrollment applications exceed seats available. All charter schools operate under a contract (or charter) with an “authorizer”, typically the state, a school district or university – that holds them accountable to the high standards outlined in their “charter”. Charters create their own school model, for example: College Prep, STEM or the Arts, and offer a curriculum of their choosing, but students are still required to participate in all statewide standardized testing. They have the freedom to hire and fire staff and teachers to best meet the needs of their students. It is common to see charter schools led by former teachers who wanted to take the lessons they learned in the classroom and apply them to an entire school. Results have been impressive, particularly in urban charter schools, where students achieved the equivalent of 40 additional days of learning growth in math and 28 days of additional learning growth in reading, when compared to their peers in district-run public schools.⁶



Charter School Facility Challenges

In almost every survey conducted, facilities rank as one of the top three challenges faced by charter school leaders. Like all public schools, charter schools are funded by a mix of state, local and federal taxes. Specifically, charter schools receive “per-pupil funding” based on the number of students they enroll (and in some states, the average daily attendance of those students) in place of their local school district. Unlike district public schools, charters schools are responsible for securing their own school facilities which, with rare exception, must be paid for with per-pupil funding revenues, that average 33% less than neighboring district schools.⁷ According to research by the Charter School Facilities Initiative (CSFI), 53% of charter schools were in facilities leased from a commercial or not-for-profit entity; 49% were in buildings that did not have space for anticipated enrollment in 5 years; 17% had to delay their initial opening date by a year or more due to facility related issues; approximately half were located in facilities originally designed to serve as something other than a school and only 27% of charter schools had constructed their own buildings.⁸ In the vast majority of cases, financing is required to meet school occupancy requirements as these capital expenditures are often several times the school’s annual revenues.



Charter School Facilities Finance Market

Charter schools often serve as a “relief valve” for school districts as enrollment growth strains the capacity of existing school facilities. In nearly all cases, district public school construction is financed by issuing bonds backed by municipal tax revenues. In 40 states, voter approval in a municipal election is required for school districts to issue new bond debt.⁹ In communities experiencing rapid population growth, school bond elections cannot be put on the ballot, much less be approved, quickly enough to meet classroom space requirements. Fortunately, an average of more than 400 new charter schools opened their doors to students each year from 2014 to 2019.¹ While they have much greater flexibility, financing new charter school facilities comes with its own set of challenges.

Because they are unlike most individual or commercial customers, nearly all banks have chosen not to offer traditional commercial loans to finance charter school facilities. As a result, public tax-exempt bond offerings are the primary form of long-term financing for charter schools to buy, build or complete major capital improvements. For schools able to meet the underwriting standards needed to access the public bond market, the cost of capital for 30 to 35-year financing is typically comparable to interest rates on home mortgages of similar maturities. Due to the limited number of buyers, however, high-yield bond funds typically receive a small premium over bonds in other sectors with the same “rating” and/or comparable risk. In spite of school ‘lockdown’ orders in many states, 2020 was another record year for tax-exempt charter school bond issuance with 152 public offerings for \$4.19 billion in par value. CAGR for total bond issuance from 2015 – 2020 was 13.4%.¹⁰

Need for Reliable Transitional Charter School Facilities Finance

While the market for established charter schools and proven charter school operators is robust, for startups and newer schools requiring large enrollment increases to meet debt service and/or schools recovering from previous financial or academic missteps, accessing capital is often extremely difficult. Many aspects of charter schools make underwriting challenging. Specifically:

- Charter schools have no independent taxing authority and cannot levy taxes.
- Revenues are not guaranteed, since charters are only funded according to actual enrollment, which forces them to compete for students with district, private and other charter schools.
- There is a mismatch between required charter contract renewals (typically every 5 to 10 years) and long loan amortizations (25 to 30 years) needed to meet annual debt service.

The learning curve and judgement required to develop the adequate investing perspective creates a significant barrier to those seeking entry into this estimated \$1 billion segment of the market.

Conclusion

While popular opinion and political support continues to ebb and flow, over the past 30 years, Charter Schools have proven to be invaluable and indispensable assets to public education in the United States. At Ecofin, we believe the growth in charter schools, in terms of both enrollment and total campuses, will continue for many, many years to come. Capital to finance high quality school facilities to meet this growth will continue to be in high demand. Ecofin is one of a handful of registered investment advisors actively originating facility financings for charter schools unable to access the public bond market. Our K-12 Education Team has more than 50 years of experience in the space that includes: underwriting, finance, real estate, workouts, governance and executive leadership of charter schools. Our strategy of a 3 to 5 year partnership with schools to facilitate their access to the market for low-cost, long-term public debt makes us unique. While the financing is for facilities, we view these as investments in a stream of government cash flows. At Ecofin, our disciplined approach to determining the risk unique to individual charter schools offers non-cyclical, current income that is largely uncorrelated with the market for publicly traded debt and equities. Because of the opportunity for exceptional tax-exempt returns and the extraordinary benefit offered to historically underserved communities, Ecofin has chosen to make charter schools a primary area of focus for our social impact investment team.

¹ National Alliance for Public Charter Schools www.publiccharters.org

² The Boston Latin School www.bls.org

³ "Compulsory Education:" <https://www3.nd.edu/~rbarger/www7/compulso.html>

⁴ National Center for Education Statistics nces.ed.gov

⁵ The Untold History of Charter Schools <https://democracyjournal.org/arguments/the-untold-history-of-charter-schools/>

⁶ Center for Research on Education Outcomes <http://urbancharters.stanford.edu/news.php>

⁷ Charter School Funding: Inequity Surges <https://cpb-us-e1.wpmucdn.com/wordpressua.uark.edu/dist/9/544/files/2018/10/charter-school-funding-inequity-surges-in-the-cities.pdf>

⁸ Top 5 Facility Struggles for Charter Schools <https://www.publiccharters.org/latest-news/2017/12/13/top-5-facilities-struggles-charter-schools>

⁹ School Bond Issues https://ballotpedia.org/School_bond_election

¹⁰ TM3, Bloomberg, Investment Company Institute

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