Charter School
Lenders' Coalition

April 8, 2013

Lisa Jones
Manager,
CDFI Bond Guarantee Program
CDFI Fund
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Ms. Jones:

The Charter School Lenders' Coalition appreciates the opportunity to submit comments on the Interim Rule for the Community Development Financial Institutions (CDFI) Bond Guarantee Program (Program).

The Charter School Lenders' Coalition (CSLC) is an unincorporated advocacy and information sharing collaboration of mission-driven, community-development practitioners that provide affordable, flexible capital for the construction of charter schools in low-income communities. The coalition includes CDFIs and other private, non-profit organizations who are pioneers in the financing of public charter school facilities.

In order to provide some context for our comments, CSLC would note the following in regards to the current landscape for CDFI and private sector investment for charter school financing:

- **CDFI Financing of Charter School Facilities:** CDFIs have developed an expertise in underwriting public charter schools. The 2011 Charter School Financing Study found that the CDFI sector deployed over $1.2 billion during the past decade (2000-2009) in original loan amounts to public charter schools with less than $2 million (0.2% of the total loan amounts made) reported as written off. With a data sample of 430 loans, the report highlights typical terms charter school loans, which CSLC strongly encourages Treasury to review when determining the Secondary Loan Requirements for a charter school asset class.

- **Charter School Access to Long-Term Capital through the Bond Market:** The 2012 Charter School Bond Issuance study found that only 478 rated and unrated bonds have been issued to meet the long-term capital needs for permanent facilities, despite having over 5,000 public charter schools operating across the country. With less than 8% of public charter schools being able to access the bond market, there is a great demand for long-term 30-year affordable financing for this sector.

  The study also highlighted the need for greater standardization of credit criteria and underwriting standards among market participants. In 2012, Fitch Ratings changed its rating criteria for charter schools and the National Federation of Municipal Analysts (NFMA) established a committee to develop improved disclosure practices for charter school bond offerings. These changes reflect the uncertainty caused by the lack of consensus in what fundamental measures the market should be using to evaluate charter school bond issues.

  Overall, the challenges that charter school operators face in accessing the municipal bond market are reflected in the high relative interest costs operators pay in debt service. Currently, only the larger, more established, operators are able to access the bond market with investment grade ratings, which translate into a lower cost of capital. Conversely, operators with non-investment grade ratings or no rating at all pay millions of dollars in additional interest diverting cash flow away from classrooms.

- **Program Related Investments from Private Foundations**: Several private foundations are helping charter schools access more affordable facilities financing through program related investments (PRIs). CSLC would note that the term of most PRIs do not exceed 10 years.

- **Other Federal Funding to Financing Charter School Facilities:** CDFIs heavily utilized two federal programs to attract private sector help charter schools finance facilities – the Department of Education's Credit Enhancement for Charter School Facilities Program and the Department of the Treasury's New Markets Tax Credit (NMTC). The Credit Enhancement program has helped finance 428 schools through FY 2011, while the NTMC has helped finance at least 125 schools through FY 2012, with 40 percent of those schools also using Credit Enhancement funds. Still, the total number of charter schools financed in part through these two federal programs represent less than 10% of the charter schools nationwide. CSLC would note that Credit Enhancement funds could be a potential source of the 3% risk share needed to participate in the Program for a charter school execution, as the Credit Enhancement funds have the ability to be used up to 35 years.

CSLC is encouraged by Treasury's efforts to establish the regulations to implement the program. Our membership understands the need for the program to have a zero net subsidy cost to the federal government. Nevertheless, the combination of full recourse to CDFI balance sheets and stringent collateral requirements on secondary loans may result in an underutilization of the Program. This would be a missed opportunity to create a source of transformative capital for the CDFI industry and the charter schools providing new educational opportunities in low-income communities. As such, we would like to comment on the following items in the Interim Rule:

- **Iterative Application Process for Additional Credit Enhancement**
  Interim Rule states, "The CDFI Fund may impose other limitations as appropriate to administer the CDFI Bond Guarantee Program including, but not limited to, requiring Qualified Issuers to obtain Credit Enhancement to safeguard against the risk of default." Treasury should clarify if the application process will have interval notifications to submit more information or be a one-time application. Ideally, the Fund's application review process should be iterative and interactive to ensure Program parameters, including the potential requirement of additional credit enhancement, are workable for CDFIs. In particular, the 2011 Charter School Financing Study found that 77 percent of charter school loans had some form of credit enhancement or guarantee, and CSLC expects that charter schools may be an asset class that requires additional credit enhancement.

- **Flexibility for Secondary Loan Requirements**
  Although the Interim Rule does not provide detail about Secondary Loan Requirements, Treasury should allow for some flexibility for Eligible CDFIs to underwrite loans with varying loan-to-value (LTV) and debt service coverage (DSC) ratios. In particular, the 2011 Charter School Financing Study found that the median LTV at underwriting was 84 percent, with the 20^{th} percentile at 70 percent, the 40^{th} percentile at 79 percent, the 60^{th} percentile at 89 percent and the 80^{th} percentile at 100 percent of LTV. It also found that the median debt service coverage ratio was 1.4, with the 20^{th} percentile at 1.3, the 40^{th} percentile at 1.4, the 60^{th}

percentile at 1.5 and the 80th percentile at 2.3. These ranges indicate the need flexible loan requirements to underwrite charter schools as an asset class.

- **Flexibility to Substitute Loans**
  Treasury should allow Eligible CDFIs to substitute Secondary Loans of similar size or delegate the authority to do so to the QIs. This allows Eligible CDFIs the flexibility to restructure Secondary Loans that may become troubled outside of the Bond Loan structure. In particular, charter schools may occasionally have cash flow issues due to the volatility of public funding for a large portion of their repayment, which may require a loan to be worked out.

- **Flexibility for Amortization Schedules on Secondary Loans**
  Given the ability for CDFIs to create additional Secondary Loans through the Relending Fund, Treasury should allow for some flexibility for Eligible CDFIs to make Secondary Loans with a partially amortizing schedule (e.g. level debt service payment with a bullet due at maturity). The 2011 Charter School Financing Study found that the most common term of a charter school loan was 7 years, and of the 154 loans that were paid off, 46 percent were refinanced by term loans, bonds or NMTCs. CSLC members are confident that charter schools are able to refinance original fixed-rate, partially amortized loans with more permanent financing, should they be financed through the Relending Fund and need that flexibility.

Finally, CSLC members also support the Opportunity Finance Network's recommendations for the Relending Fund to ensure that Eligible CDFIs are putting more capital to work:

- **Relending Calculation:** The Relending Account is defined as "10 percent of the principal amount outstanding of Bond Issue, minus the 3 percent risk-share pool." To maximize the revolving capacity of the Bond Program, we recommend that the "principal amount outstanding" be defined as the total amount of the initial Bond Issue.

- **Relending Constraints:** To ease the challenges of asset-liability matching, we recommend a 12-month window to reduce Relending Subaccount balances, similar to reinvestment provisions that exist in the NMTC program. In addition, the Fund should measure the Relending Subaccount at a given time (i.e. on a date certain, such as 12/31). This would make it possible for Eligible CDFIs to adjust accordingly, and for the Master Servicer/Trustee to monitor those accounts effectively, without triggering a series of "Notification Dates" and "Calculation Dates," as outlined in the Interim Rule.

Thank you for the opportunity to comment on the interim rule. Please contact myself at klatimer-nelligan@liifund.org or Caitlin Kovalkoski at ckovalkoski@liifund.org if you have any questions about our comments.

Sincerely,

Kim Latimer-Nelligan
Chair, Charter School Lenders' Coalition