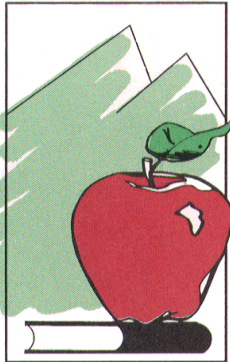


California Charter Schools Association 2013 Annual Conference

Charter Working Capital *El Dorado County Superintendent of Schools* *Research on the Landscape*



Presented by Dr. Vicki Barber, El Dorado County Office of Education
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Lori Raineri, Government Financial Strategies
March 13, 2013

Agenda

- **Working Capital Need (Deferrals)**
- **Working Capital Borrowing Options (Districts/Charters)**
- **Legislative Solutions**
- **El Dorado County Superintendent of Schools' Research**
- **Cost of Borrowing**
- **Development of Credit Market for Charters**
- **Closing**



Working Capital Need



**"I'd like to borrow just enough
to get myself out of debt."**

WORKING CAPITAL NEED DEFERRALS

Deferrals –It’s getting better all the time...

■ Deferral Defined:

- Inyear. State pays you late but within the fiscal year.**
- Interyear. State pays you really late – next fiscal year.**
- Some waivers possible – but doesn’t solve the problem**

■ K-12 deferrals reduced by \$2.2 billion in 2012-13

■ At the peak of deferrals, approximately 45% of state aid payments owed to school districts were deferred to the following year.

2011-12 Deferral Schedule	Amount	Repayment Month	Intra-Year or Inter-Year?	Deferral Exemption Process?	Principal Apportionment Deferral Impact	Authority
Jul-12	\$700 million	Sep-12	Intra-Year	Yes	75% of 2012-13 Advance	<i>Government Code (GC) 16325.5 and 16326</i>
Jul-12	\$500 million	January 2013*	Intra-Year	Yes	25% of 2012-13 Advance	<i>GC 16325.5 and 16326</i>
Aug-12	\$600 million	January 2013*	Intra-Year	Yes	60% of 2012-13 Advance	<i>GC 16325.5 and 16326</i>
Oct-12	\$800 million	January 2013*	Intra-Year	Yes	46% of 2012-13 Advance	<i>GC 16325.5 and 16326</i>
Feb-13	\$531.7 million	Jul-13	Inter-Year	No	31% of 2012-13 P-1	<i>EC 14041.6</i>
Mar-13	\$1.029 billion	Aug-13	Inter-Year	No	60% of 2012-13 P-1	<i>EC 14041.6</i>
Apr-13	\$594.7 million	Jul-13	Inter-Year	No	35% of 2012-13 P-1	<i>EC 14041.6</i>
Apr-13	\$763.8 million	Aug-13	Inter-Year	No	45% of 2012-13 P-1	<i>EC 14041.6</i>
May-13	\$1.977 billion	Jul-13	Inter-Year	No	100% of 2012-13 P-1	<i>EC 14041.6</i>
Jun-13	\$474 million	Jul-13	Inter-Year	Yes**	100% of 2012-13 P-2	<i>EC 14041.5, 14041.6, and 14041.7</i>

*Deferral repayment accelerated to December 2012 from January 2013 by the Department of Finance, State Controller's Office, and State Treasurer's Office under the authority of Government Code sections 16325.5 and 16326. In addition, the \$900 million March to April deferral has been cancelled.

**EC 14041.7 allows an LEA that will be unable to meet its financial obligations in the month of June to apply for an exemption from the June P-2 deferral.

Deferrals Have An Unequal Impact

- Charter A & B have equal ADA and funding rates.
- Charter A is funded primarily on property taxes, as a result the impact of deferrals is minimal.
- Charter B has limited property taxes and higher state aid, as a result the impact of deferrals is significant.

1		Charter A	Charter B
2	ADA	1,000	1,000
3	Rate per ADA	5,000	5,000
4	ADA x Rate	5,000,000	5,000,000
5	Property Tax	4,500,000	500,000
6	State Aid	500,000	4,500,000
7	% deferred at year end	30%	30%
8	Cash impact at year end	\$ 150,000	\$ 1,350,000

Cash Flow - Other

- **Deferrals are the primary reason for the current cash flow crisis**
- **But each charter cash flow varies based on the ratio of property taxes to state aid**
- **Operational expense outgo may not align with cash inflows**
 - **e.g. A growing charter will incur more expenses but state aid doesn't recognize the growth in ADA until February**

Deferrals 2013-14

■ The Governor's Budget (January proposal)

- \$1.8 billion to eliminate some of the interyear deferrals
- End of 2013-14, \$5.6 billion in deferrals still anticipated

Conclusion:

The Governor is committed to reducing deferrals.

Will the legislature uphold that priority in a final budget?

When will they disappear entirely?

Bottom line – we still have cash flow needs.

Stay tuned.....

CASH BORROWING OPTIONS DISTRICTS VERSUS CHARTERS

District Options for Cash Borrowing

Inter fund borrowing (Education Code Section 42603)

Rate = County Treasury Rate (typically <1%)

Tax and Revenue Anticipation Notes (TRANS)

Rate = Varies but 1% to 2%

County Office of Education (EC 42621,42622)

Rate = Usually County Treasury Rate (typically <1%)

Borrowing from County Treasurer (EC42620)

Rate = Usually County Treasury Rate (typically <1%)

Charter Traditional Borrowing Options

- **Payment Terms with Vendors**
- **Loans from**
 - **Bank or Credit Union**
 - **Authorizer**
 - **Private party**
 - **Community Development Finance Institutions**
- **Issuance of Revenue Anticipation Notes**
- **Sale of Receivables**
- **Range of costs from 5% to 20%**



**NEW LEGISLATION
OPENS THE DOOR FOR MORE OPTIONS
FOR CHARTERS**

Charter Cash – New EC Language (2012-13)

SEC. 54. Section 47603 of the Education Code is amended to read:

47603. (a) This part shall not be construed to prohibit any private person or organization from providing funding or other assistance to the establishment or operation of a charter school.

(b) (1) A charter school may contract with a county superintendent of schools or a county board of education for purposes of borrowing moneys pursuant to subdivision (f) of Section 1042.

(2) Moneys borrowed pursuant to subdivision (f) of Section 1042 shall be expended by a charter school solely for purposes of meeting the cash management needs of the charter school due to the deferral of apportionment payments pursuant to Sections 14041.5, 14041.6, 14041.65, and 14041.7 and pursuant to Sections 16325, 16325.5, and 16326 of the Government Code and shall not be used for purposes of making capital acquisitions.

(c) This section shall become inoperative on July 1, 2017, and, as of January 1, 2018, is repealed, unless a later enacted statute, that becomes operative on or before January 1, 2018, deletes or extends the dates on which it becomes inoperative and is repealed.

Charter Cash – New EC Language (2012-13)

- **SEC. 51. Section 42621 of the Education Code is amended to read:**
- **42621. The county superintendent of schools of each county, with the approval of the county board of education, may make temporary transfers to a school district or charter school that does not have sufficient money to its credit to meet current operating expenses from the county school service fund, in amounts and at times that the county superintendent of schools deems necessary. These transfers shall not exceed 85 percent of the amount of money accruing to the school district or charter school at the time of transfer. The amounts so transferred shall be repaid to the county school service fund before June 30 of the current year from any funds subsequently received by the school district or charter school.**
- **SEC. 52. Section 42622 of the Education Code is amended to read:**
- **42622. The county superintendent of schools, with the approval of the county board of education, may make an apportionment to a school district or charter school from the county school service fund conditional upon the repayment to the fund during the next succeeding fiscal year of the amount apportioned to the school district or charter school and, during the next succeeding fiscal year, shall transfer the amount of the apportionment from the general fund of the school district or charter school to the county school service fund.**

Summary

County offices of Education (COE) may make cash loans to charter schools

- » **COE (not an authorizer) may enter into a contractual agreement**
- » **For cash flow due to deferrals, not for capital acquisition**
- » **Authorization through July 2017**
- » **Current County Superintendent of Schools authority to make transfers/advance apportionments to school districts is extended to charter schools as well.**

EL DORADO COUNTY OFFICE OF ED TESTING THE MARKETPLACE

Testing the Market Place

■ Assumption

- Start with a core group of charters
- History of strong leadership
- Track record of student achievement
- Solid financial expertise
- Balance sheet with strong net asset position
- Test the market place for competitive interest rates



El Dorado Charter Cash Options Corp.

■ “ECCO”

- Established by El Dorado County Office of Education**
- Intended to provide a vehicle to bring charters together to the marketplace and influence borrowing options for charters**
- Ability to coordinate intercept agreements**

■ Explore Partnerships with other agencies

- E.g CA School Finance Authority**

■ Coordinate an RFP (Request for Proposal)

CA School Finance Authority

- **The California School Finance Authority (CSFA) was created in 1985 to finance educational facilities and provide school districts and community college districts access to working capital. Since its inception, the Authority has developed a number of school facilities financing programs and most recently is focused on assisting charter schools to meet their facility needs.**
- **The Charter School Facilities Program is a \$900 million program that provides low-cost financing for charter school facilities. Projects will receive 50 percent of their costs in the form of a state grant, while the school is responsible for the balance of the project costs through either a lump sum matching payment or a long-term loan from the state.**
- **The Charter School Facilities Credit Enhancement Grant Program is an \$8.3 million program that serves to fund debt service reserves for the financing of acquisition, renovation, or construction of charter school facilities, or the refinancing of existing charter school facility debt.**

Results of our RFP

■ Encouraging

- More vendors recognizing charters as a lending opportunity
- More competition means lower rates

■ Discouraging

- Rates still higher than those currently experienced by school districts
- School districts generally have higher reserves than charters (20%+)
- Charters can (and do) close operations and go out of business

RESULTS OF RESEARCH

Research

- **Request for Proposal sent to 30 financial institutions and finance companies**
- **Proposals received from 5 Teams**
 - » **Interviews and follow up discussions were held**
- **What we learned**
 - **Lenders with the most knowledge of charter credit had limited access to capital to lend.**
 - » **Couldn't satisfy a large need or pricing was high.**
 - **Lenders with best access to capital had least knowledge of charter credit.**
 - » **Pricing was high.**

Cost for \$1 M Borrowed: 4.32% - 21.38%

Working Capital Financing - Comparison for \$1 Million Desired Borrowing Amount

Relevant Deferral Schedule*	% of Total	Event	Receivables Sale Range of Discount Rates		Receivables Sale	Line of Credit Range of Interest Rates		Tax-Exempt RANs Example Rate of	Tax-Exempt RANs Stated Interest Rate of
			2.80%	6.50%	7.00% Discount Rate	Prime + 1.00%	Prime + 4.00%	4.00%	4.25%
January, 2013		Funding Occurs	\$972,000	\$935,000	\$730,000	\$999,700	\$999,700	\$985,000	
February, 2013	5.90%	Repayment	(\$131,082)	(\$131,082)	(\$104,866)	(\$131,082)	(\$131,082)	(\$131,082)	
March, 2013	0%		\$0	\$0	\$0	\$0	\$0	\$0	\$972,500
April, 2013	6.33%		(\$140,635)	(\$140,635)	(\$112,508)	(\$140,635)	(\$140,635)	(\$140,635)	\$0
May, 2013	0%	Repayment	\$0	\$0	\$0	\$0	\$0	\$0	\$0
June, 2013	0%		\$0	\$0	\$0	\$0	\$0	\$0	\$0
July, 2013	19.23%	Repayment	(\$427,238)	(\$427,238)	(\$341,791)	(\$427,238)	(\$427,238)	(\$427,238)	(\$427,238)
August, 2013	13.55%	Repayment	(\$301,044)	(\$301,044)	(\$240,835)	(\$319,774)	(\$333,275)	(\$318,660)	(\$590,470)
	45.01%		100.00%						

*Per SSC, The Fiscal Report, 11/21/12

Assumptions

Desired Amount to be Borrowed \$1,000,000
 All funding/draws occur in January, 2013, except for XXXXXXXX
 All deferrals rec'd. after funding are applied to repayment, except for XXXXXX.

Notes

It should be noted that the XXXXXXXX and XXXXXXXX allow flexibility of repayment timing.
 It should be noted that borrowers may draw down funds at different times and in varying amounts under all options.

	Receivables Sale 100% of Receivables Range of Discount Rates	Receivables Sale 80% of Receivables 7.00% Discount Rate 1.75% Origination Fee	Taxable Line of Credit Dec. 21, 2012 US Prime Rate (WSJ) 3.25% It is expected that tax-exempt rates would be less. \$300 Charge Per Advance	Tax-Exempt RANs 0.50% Underwriting Fee \$7,500 Doc. Fee (1st Time, otherwise \$1,500) \$2,500 Charter School Costs (est.)	Tax-Exempt RANs through XXXX 0.75% Origination Fee 2.00% Transaction Costs (lesser of \$25,000 or 2%) \$3,500 Charter School Costs for Legal Opinion (est.)
	2.80% - 6.50%		4.25% - 7.25%		
TIC (annualized)	6.56%	15.62%	21.38%	4.32%	7.32%
Net Received at Closing	\$972,000	\$935,000	\$730,000	\$999,700	\$999,700
Total Repayment	\$1,000,000	\$1,000,000	\$800,000	\$1,018,730	\$1,032,231
				\$985,000	\$972,500
				\$1,017,616	\$1,017,708

TIC (annualized) 6.56% 15.62% 21.38% 4.32% 7.32% 7.48% 11.97%

✓ *Timing of cash flow (in and out) is important*

✓ *TIC or True Interest Cost is the real cost of borrowing*

Charter Credit Is Hard to Understand



"Dad, I need a note for school tomorrow ... preferably a \$10 bill."

Bank Credit Analysis

■ Charter Credit

- Credit strengths often include:
 - » Growth in Accounts Receivable
 - » Increasing Days Cash on Hand
- Credit weaknesses often include:
 - » Operating losses
 - » Minimal Assets and Lack of Growth Trend in Assets
 - » Lack of Secondary Repayment Source
 - » Lack of Cash
 - » Current Ratio (Current Assets/Current Liabilities)
 - » Quick Ratio (Cash + Marketable Securities + Receivables)/Current Liabilities

Important Rating Agency Credit Factors

- **All three rating agencies, Standard & Poor's, Moody's and Fitch, have published credit rating criteria for charter schools and for short term ratings.**
 - **Charter criteria are focused primarily on long term credit quality.**
 - **Short-term credit is dependent on operating performance, revenue quality, cash flow projection reliability, and long term credit evaluation.**
 - **The vast majority of rated short-term notes issued by State and local governments in the United States carry the highest short-term credit rating.**



“Good” Commercial Credit Characteristics

- **Credit characteristics which are considered “good” fall into three categories:**
 - **Short Term Liquidity (Cash Flow Statement)**
 - **Capital Structure and Solvency (Balance Sheet)**
 - **Operating Performance (Income Statement)**



“Good” Credit Characteristics ≠ Charters

■ Short Term Liquidity

- Measured from Balance Sheet ratios; a public school dependent on State revenues or local property taxes usually monitors with a cash flow projection.**

■ Capital Structure and Solvency

- Measured from the Balance Sheet by looking at the severity of debt claims on the cash flow; debt can pose the same threat for a charter school, though many are low debt. No equity, but Fund Balance.**

■ Operating Performance

- Measured by margins and profit over a month, quarter or year. Public school operating performance may be better reflected over multiple years.**

Credit Enhancement May or May Not Help



✓ *Information needs to be packaged for the user.*

Revenue Quality

“Revenues derived from other governmental entities, such as state aid funding, could exhibit historical volatility, especially in the face of an adverse budget climate, that could make timing and amount of future receipts uncertain.”

» Standard and Poor’s Criteria for Short-Term Debt

- ✓ *Sample charter schools rely on State revenue and suffer cash flow shortfalls from deferrals in similar proportions to school districts, but have important credit limitations related to potential failure and a lack of uniformity on other credit characteristics.***
- ✓ *Still, CSFA State revenue intercept is an important credit feature.***

How Can Charters Affect Their Credit?

- **If charter schools don't fit conventional credit standards (for business or for public agencies), what can be done to improve the fit and at what cost?**
 - Charter school lending market has information asymmetries.
 - Is there revenue quality which can be measured differently?
 - If so, will this result in improved access to capital?

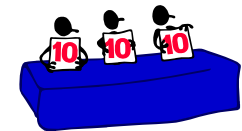


Academic Evidence Supports Charters' Exp.

- **“First . . . banks charge higher interest rates and finance relatively less creditworthy borrowers in market segments with greater information asymmetries.**
- **Second, when faced with greater competition from outside lenders, banks reallocate credit toward more captured borrowers (flight to captivity).**
- **Third, if borrower quality and captivity are sufficiently correlated, an increase in the competitiveness of uninformed lenders can worsen the informed lender’s overall loan portfolio.”**
 - **Dell’Ariccia, Giovanni, and Robert Marquez, 2004, “Information and bank credit allocation,” *Journal of Financial Economics*, 72, pp. 185–214.**

Price System is Not Working

- **Price system of capital allocation not working for charters**
 - Comparison to school districts, the most frequent issuer of Tax and Revenue Anticipation Notes, may be harmful
 - Hospitals may be a better metaphor
- **Information asymmetries in the municipal market have historically been addressed by third party independent opinions of creditworthiness, i.e. rating agencies.**
 - Charter schools can work collectively to standardize cash flow projections and obtain short term credit ratings.



Development of Credit Market for Charters

- **Information is the traditional answer to an information problem.**
 - **Investing in charters occurs through private placements, public offerings, and commercial lending.**
 - **An education effort about short term charter credit could be directed to each of these markets.**
 - **Certification of credit via credit rating has value.**

Education and Certification

■ Collective Effort to Focus on Short-Term Credit

– Education effort

» Demonstrate the value of charter credit through agreed improvements in timely and complete financial reporting including presentation of financial ratios and trends, use of a web site to provide downloadable information (perhaps even comparisons), road shows, and investor calls.

– Certification of credit via credit rating

» Address the 3 rating agencies to make short term credit criteria more specific and the highest short term credit ratings attainable

✓ *Both of these have been pursued by individual charter schools for individual benefit.*

NEXT STEPS

CHARTERS NEED TO GET BETTER AT MANAGING CASH, CASH FLOW REPORTING, AND ANALYZING TRUE COST OF BORROWING

MARKETPLACE NEEDS TO BECOME BETTER EDUCATED ABOUT CHARTERS

Quality Cash Projections Are Key

■ The projections need to be:

- Accurate
- Flexible
- Well-documented



■ Not as easy as it sounds, especially given...

- Limited need / experience preparing accurate cash projections.
- Timing concerns (e.g., May revision, adopted charter budget, adopted State budget).



Common Problems

- **Apportionment deferrals not included / up to date.**
- **Use of prior year receipts / disbursements as template can be inaccurate.**
- **Cash vs. Revenue**
 - **Individual monthly entries should reflect changes in cash, not accounting revenue and expense.**
- **How to handle prior year receipts / disbursements?**

Cash Flow Projection Checklist

- **Tie beginning cash figures to Audit**
 - Document discrepancies (e.g., revolving cash).
- **Design spreadsheets to be flexible**
 - Separate table with apportionment deferral % which can be adjusted to reflect new deferrals from the State.
- **Document assumptions on spreadsheet (use comments)**
 - Budget version used as starting point.
 - Apportionment deferrals included.
 - Impact of potential carryovers.
- **Update cash flow projections monthly**



Banking Relationship Checklist

■ How Well Do You Know Your Banker?

- Does Your Local Banker Have Lending Authority?
- Does Your Bank Issue Credit Cards?
- What Services Can Your Bank Offer?
- How are Services Priced?

■ How Well Does Your Banker Know You?

- Obtain Input from Your Banker on Credit Information They Review
- Match Audit Engagement Requirements to What Your Banker Wants to See
- Review Charter Financials with Banker at Least Once a Year

■ Basic Services

- Checking account
- Business savings account
- Credit card
- Deposit-only card
- Discounted employee checking accounts
- Online banking

■ Lending Services

- Lines of credit
- Term-loans
- Commercial real estate
- Equipment leasing
- SBA loans

■ Cash Management

- Wire transfers
- Wholesale lockbox
- Merchant services

■ Other

- Payroll
- Retirement accounts
- Insurance
- Discounts with other vendors



Conclusions

- **Strong cash flow management and borrowing skills are growing among charter schools – but there is room for improvement.**
- **We need to do a better job of educating the financial lending institutions about charter schools.**
- **Charter schools will benefit from cooperative efforts to approach the marketplace in a “united front”.**
 - **This would result in a change on the “demand-side”.**

