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Charter Schools Face Higher Capital Costs if Congress Ends PABs.

BRADENTON, Fla. — Charter schools could face significant growing pains if Congress passes a tax bill that bans the use of private activity bonds.

Even though the first charter school issued bonds 19 years ago, the sector remains a small but steadily emerging segment of the municipal market.

Without access to tax-exempt financing as proposed in H.R. 1, the Tax Cuts and Jobs Act, start-up charter schools face an uncertain future while existing schools could struggle to expand, analysts and industry experts said.

The bill is pending in the House of Representatives. Senate Republicans are also working on tax legislation, releasing a proposal that spares PABs.

"The recently proposed federal tax reform bill in its current form would be a huge blow to all public charter schools that depend on bond financing," said Lynn Norman-Teck, executive director of the Florida Charter School Alliance, referring to the House bill.

"Without access to this low cost source of financing, public charter schools would need to turn to other sources of capital, which would be more expensive and restrictive," she said. "The additional costs of alternative capital would pull money out of the classroom where it is needed the most."

Florida's 654 charter schools enrolled 283,755 students in the 2016-17 school year, according to the Florida Department of Education.

Charter schools are publicly funded nonprofit or for-profit public schools that operate under a contract or charter from a local school district or state charter authorizer. Most teach students from pre-kindergarten through high school.

They offer tuition-free access to students, and typically enjoy more flexibility from regulations than a traditional public school.

Viewed as an innovative form of education over traditional public schools, charter schools are supported in most states and by President Donald Trump.

Trump's pick to lead the U.S. Department of Education, Betsy DeVos, is an ardent supporter.

"Parents no longer believe that a one-size-fits-all model of learning meets the needs of every child," DeVos told the U.S. Senate Committee on Health, Education, Labor and Pensions during her Jan. 17 confirmation hearing. "And they know other options exist, whether magnet, virtual, charter, home, faith-based or any other combination."

For that reason, charter school supporters were surprised that the House GOP proposed eliminating low-cost financing for them.

“I would be highly distressed, regardless of where you are on charter schools,” California Deputy Treasurer Tim Schaefer, referring to the potential elimination of PABs.

“You can be friend or foes to charter schools, but here in California there are parents demanding that alternative,” he said. “If you take away from the charter schools, the ability to finance…you are denying people those choices, because it would create an environment where they are unsustainable.”

California has the highest number of students in charter schools, at 602,840, according to an October 2017 enrollment report by the National Alliance for Public Charter Schools.

Texas has the second-highest enrollment, with 303,130 students, and Florida came in third.
To access the bond market, most charter schools must be 501(c)(3) nonprofit entities. Conduit issuers are used to sell their tax-exempt bonds, though there are a few exceptions.

Since the first $11 million of bonds were issued in 1998, a total of $17.73 billion of bonds have been sold for such facilities across the U.S., according to an issuance database created by Wendy Berry, a NewOak director and senior analyst.

If Congress eliminates PABs, Berry said charter schools will encounter higher borrowing costs using other financing options, and they will have fewer dollars to spend on the core mission of education programming.

“I think this was a big surprise for the folks who follow this the closest, the folks who make sure the municipal market is represented in the halls of Congress,” she said. “This was not something that was discussed.”

Berry, who specializes in covering the charter sector, said “there have been a surprising number of taxable deals done.” Some federal financing programs are available, though they are also taxable.

“It’s not good news, obviously,” she said.

Minnesota passed the first charter school law in 1991, with California following suit in 1992.
Today, more than 6,800 charter schools in 43 states and the District of Columbia educate nearly 3 million students, according to the National Alliance for Public Charter Schools.

Some 67% are independently run non-profit, single-site schools; 20% are run by non-profit organizations that run more than one charter school; and 13% are run by for-profit companies, according to the Alliance.

The House bill would also remove other sources of charter school capital funding such as new markets tax credits, qualified zone academy bonds, and other tax credit programs, S&P Global Ratings said in “U.S. Tax Reform: Municipal Credit And Market Implications,” a Nov. 9 report.

“While charter schools in some states – for example Colorado, Arizona, Nevada, and Michigan – may qualify to still issue debt as governmental bonds, most states are not currently set up to do so and would require additional legislative action to be eligible,” the S&P report said.

The House bill would “significantly curtail new market activity” and make it even more difficult for start-up or new charter schools to finance their school buildings, or for existing schools to expand, S&P analysts said.

In Michigan, 10% of students are enrolled in 294 charter schools, which are considered public school academies. Any parent, teacher, group or entity can apply for a charter, except private school operators.

As public schools, charters in Michigan receive per-student base funding. They also are eligible for governmental bond issuance.

In 1979, charter schools became eligible under the State School Aid Act to borrow from the Michigan Municipal Bond Authority, using its shared credit rating. The authority issues state qualified school bonds.

Most states have not created such entities, and charter schools rely on conduit issuers to sell tax-free private activity bonds as 501(c)(3) nonprofits.

In response to the charter school facility financing challenges, the California Legislature passed Assembly Bill 2717 in 2006, making charter schools eligible for financing assistance through the California School Finance Authority, according to the CSFA's Conduit Bond Program Report.

The CSFA has issued about $1 billion of private activity bonds for charter schools since then, according to Deputy State Treasurer Vince Brown. The CSFA also has an intercept program to make sure the debt service gets paid to the bondholders, he said.

The CSFA has been the largest issuer of charter school debt in the state, issuing 64% of the total par amount since 2010 and 75% of the par amount since 2013, "thereby distinguishing itself as the primary conduit bond issuer for California charter schools," according to the authority's report.

The National Alliance for Public Charter Schools, in a Nov. 7 letter to House Committee on Ways and Means Chairman Kevin Brady, R-Texas, and ranking member Richard Neal, D-Mass., said several provisions in H.R. 1 would be "devastating" to charter schools.

In addition to eliminating PABs, the act would terminate the use of advance refundings and remove a charter school's ability to finance new projects with new markets tax credit financings and qualified zone academy bonds, said the two-page letter by Alliance President Nina Rees.

From 2003 through 2016, NMTC investments in charter schools totaled $1.99 billion, supporting academic space for 200 public charter schools and leveraging $3.21 billion in total project financing, Rees wrote.

"Early-stage schools would be put at a particular risk by the elimination of NMTCs as those credits typically support the development and construction of new buildings," she said. "The result of this bill is that some charter schools would not be able to afford a facility."

NewOak's Berry described the situation in Congress as the "first inning of what is likely to be an extra-inning ballgame."

"The Senate has released their version and it's totally different from the House," Berry said. "I'm optimistic if the worse comes to fruition then they will pay higher borrowing costs but it will not be the end of the ability to finance charter schools."

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