Charter Policy Issue Brief

Charter school access to tax-exempt financing

This document examines state policies that support charter school access to tax-exempt financing, along with mechanisms increasing their accessibility and affordability. Due to its advantageous tax treatment, tax-exempt bond financing provides some of the lowest-cost financing available to charter school borrowers.

This document is divided into two sections: The first one focuses on a table that presents various details about each state's policies for charter school access to tax-exempt financing; the second section outlines some policy considerations for state policymakers and advocates to wrestle with when designing a policy to provide charter school access to tax-exempt financing.

Section I: State policies for charter school access to tax-exempt financing table

As of this writing, 34 states and the District of Columbia provide charter school access to tax-exempt financing. The table below presents various details about each state's policies for charter school access to tax-exempt financing.

The states are listed in order of the percentage of bond transactions by charter school count in 2022, from largest to smallest. The two states over 100%, which denotes the state had more transactions than charter schools, is a sign of individual charter schools undertaking more than one transaction, either in a single year or over multiple years. The transaction data in the table is current as of December 2023. Special thanks to the Local Initiatives Support Corporation for providing data from its recently updated bond report.

A text box after the table provides more information about each column.

State	Percentage of charter schools accessing financing	Total amount	Number of transactions	Number of issuers	Average transaction
Massachusetts	119.20%	$1,156,984,426	93	4	$12,440,693
Colorado	104.90%	$3,590,307,388	276	3	$13,008,360
Utah	86.10%	$1,530,412,000	118	8	$12,969,593
Delaware	69.60%	$228,850,000	16	6	$14,303,125
Idaho	64.00%	$344,234,673	48	1	$7,171,556
Arizona	46.90%	$4,716,406,667	268	14	$17,598,532
Michigan	44.90%	$1,176,231,440	168	70	$7,001,378
District of Columbia	44.00%	$1,344,396,000	55	2	$24,443,564

North Carolina	42.60%	$1,578,817,399	87	3	$18,147,326
Pennsylvania	42.50%	$1,641,876,680	76	11	$21,603,641
Nevada	41.90%	$968,795,000	39	6	$24,840,897
Minnesota	40.40%	$1,499,245,000	112	34	$13,386,116
New Jersey	37.90%	$656,975,000	33	7	$19,908,333
Rhode Island	37.50%	$94,715,000	15	1	$6,314,333
South Carolina	30.30%	$374,572,500	27	2	$13,873,056
Florida	24.70%	$3,999,381,124	172	32	$23,252,216
Texas	24.60%	$7,712,420,000	209	33	$36,901,531
Illinois	22.60%	$526,832,603	30	8	$17,561,087
Maryland	20.40%	$190,836,000	10	3	$19,083,600
Georgia	19.60%	$245,100,000	19	15	$12,900,000
Indiana	19.30%	$283,187,000	23	3	$12,312,478
California	18.00%	$3,417,250,120	171	11	$19,983,919
New Mexico	17.20%	$181,805,000	17	3	$10,694,412
New York	16.10%	$1,784,255,000	53	14	$33,665,189
Arkansas	14.40%	$166,430,000	13	2	$12,802,308
Missouri	11.30%	$140,195,000	9	4	$15,577,222
Connecticut	9.50%	$22,340,000	2	1	$11,170,000
Louisiana	9.30%	$306,051,994	14	3	$21,860,857
Washington	6.30%	$18,600,000	1	1	$18,600,000
Oregon	5.40%	$46,230,000	7	1	$6,604,286
Tennessee	4.30%	$74,293,333	5	9	$14,858,667
Ohio	4.00%	$186,200,000	13	7	$14,323,077
Oklahoma	2.90%	$37,630,000	2	2	$18,815,000
Hawaii	2.70%	$26,945,000	1	1	$26,945,000
Wisconsin	1.50%	$70,758,333	5	6	$14,151,667

State policies for charter school access to tax-exempt financing table column descriptions

Percentage of charter school accessing financing: The number of transactions divided by the 2022 number of charter schools in each state to determine a proxy of what proportion of charter schools have accessed tax-exempt financing to date. In some cases, a single school has had multiple transactions either for a single project or year or for multiple projects and years. For this reason, the rate can be over 100%.

Total amount: The total sum of the par amount of tax-exempt bond financing to date based on the LISC data through 2022.

Number of transactions: The total number of transactions to date based on the LISC data through 2022.

Number of issuers: Based on 2022 LISC data, the total number of individual issuers in each state. Some states allow charter schools to issue their own bonds (e.g., Michigan), while others require another entity to do it, such as a city or a state finance authority.

Average transaction: Based on the total amount of transactions and the total number of transactions, we determined the average transaction for each state across all years of financing.

Section II: Policy considerations

The benefit of tax-exempt financing is the potential for attractive interest rates compared to other financing options. The key driver of interest rates, however, is the charter school borrower's credit rating and what the market is paying for bonds of that credit quality at that moment. Absent credit enhancement arrangements, state statutes dealing with bond financing have little to do with the ultimate interest rates schools pay.

The most important consideration is making sure tax-exempt financing is available to charter schools. As the analysis above shows, there are a few states that either over or under-perform relative to their total charter school numbers.

Beyond the big-picture analysis of issuance figures, there are secondary considerations and related policies that can make a difference for charter school borrowers.

Charter school bonds are commonly issued through "conduit issuers," which are public or quasi-public entities authorized to issue tax-exempt debt. Ideally, issuers are accessible, affordable, and attentive to the unique needs of charter school customers. Among the hundreds of potential issuers across the country, there's presumably a range of accessibility, affordability, and attentiveness.

Michigan — and to a lesser extent, Massachusetts — offers a limited exception to the use of conduit issuers. Michigan's statutory structure governing charter schools and IRS rulings of limited application have enabled significant numbers of charter schools to issue their own tax-exempt debt:

A Michigan public school academy (charter school) is defined as a "public school" under the Michigan Revised School Code. Accordingly, in 1997 the state-wide conduit issuer received a Private Letter Ruling from the IRS that charter schools could participate in its pooled cash flow borrowing program without jeopardizing the pool's tax-exempt status.

Further guidance was received from the IRS in 2006, when the Service issued a Technical Advice Memorandum (TAM) in connection with the audit of a particular charter school financing issued directly by an academy to a financial institution. The TAM concluded that because the academy in question was a nonprofit corporation formed pursuant to a contract with a state university, under which the university board approved and appointed the academy board, the debt of the academy was issued "on behalf of" the state of Michigan (a term of art under IRS Revenue Ruling 63-20) and could appropriately be designated as tax exempt without a conduit issuer. It should be noted that (i) under the Internal Revenue Code, TAMs are not to be used or cited as precedent, and (ii) in Michigan, charter schools can be authorized by a number of different types of authorizing bodies under contracts containing various terms. Accordingly, the TAM is helpful, leading to some Michigan charter schools issuing their own tax-exempt debt. Many lawyers, however, do not believe the TAM supports a universal conclusion that all Michigan charter schools may issue tax-exempt debt without using a conduit and Michigan conduit deals remain common.

By contract, most authorizing bodies require the charter school and the third-party lender or conduit entering into a financing to agree to certain conditions concerning the authorizer, as fiscal agent, with respect to transferring state school aid funds as payment to secure the debt. These include among others: (i) that the debt is the charter school's debt and not the debt of the authorizer body; (ii) the authorizing body is not responsible for and does not provide any guarantee for any payment owed by the charter school; and (iii) the authorizer body has the authority under state law and the contract to terminate, reconstitute or revoke the contract at any time.

It's beyond the reach of this review to get into the details of individual issuer costs and policies. However, suffice to say, there are additional considerations of the mechanisms available for this topic. The first is having multiple issuers available, with charter school borrowers benefiting from the competition and diversity of available issuers. The second is a preference for issuer transparency. **Utah** provides a great example, where relevant transaction costs are openly available for anyone, including other charter schools, to review and compare.

State statutes vary widely in terms of how explicitly they provide charter schools with access to tax-exempt bond financing. Some charter school statutes clearly authorize schools to incur long-term debt and own real estate, while others do not. Some identify a specific conduit issuer for charter school bond financing, while others do not. In quite a few states, charter schools are not eligible to be the direct recipient of bond financing and must instead use a related third party to facilitate the transaction. However, upon comparing states with the most complete set of positive provisions against states with less favorable provisions, there doesn't seem to be much difference in the financing records of these states.

The Tax Equity and Fiscal Responsibility Act of 1982 requires local officials to hold a public hearing and provide formal approval for any tax-exempt bond issuances taking place in their jurisdiction. The process for TEFRA approval differs by state, and many states have had little or no problems with the process. However, in states where the only option for approval involves units of local government that may be hostile to charter schools, the process can be used to block tax-exempt financing entirely. Texas and North Carolina have recently addressed those challenges by establishing elected statewide officials (e.g., attorney general, superintendent of public instruction) as options for TEFRA approval.