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Charter Schools

Summary

This report provides a detailed explanation of Moody's rating methodology for charter schools. It explains our methodology and discusses key credit factors — both qualitative and quantitative — and how we evaluate them, and includes an overview of the charter school sector and discusses trends shaping credit for charter schools over the next several years. The key credit factors are:

1. Market Position
2. Governance and Management
3. Financial Position and Performance
4. Covenants and Legal Framework
5. Charter and State-Specific Credit Factors

Each of these factors is discussed in detail in the main text. Due to highly competitive market environments, frequently small or inexperienced management teams, and generally narrowly balanced finances, charter schools often face unique credit challenges. Nevertheless, in many right circumstances, charter school debt can be rated investment grade. The exhibit "Anatomy of an Investment Grade Charter School" summarizes the characteristics of a typical investment grade charter school. The appendices include a list of Moody's rated charter schools, definitions of the quantitative measures used for the charter school sector and Moody's rating definitions.

Overview of Charter Schools

Charter schools are privately operated, publicly financed schools that are formed when individuals or organizations are granted a contract (i.e. charter), by the authorized body in their state, which is usually a state education department, school district. or university. Charter schools represent a market-based approach to public education with the underpinning philosophy that underperforming schools, or schools for which demand does not support operations, must improve their performance or shut down. No students are zoned to attend charter schools, which must accept all applicants within the physical capacity of the school building. When the applicant pool exceeds that capacity, lotteries are generally held to govern admission. Some charter schools are formed because the traditional public schools are perceived as under-performing or overcrowded. Others are formed to provide a curriculum that differs from that of existing public schools (i.e. Montessori or Core Knowledge).

Because charter schools are funded by the state on a per-pupil basis generally in the same amount that is provided to traditional public schools to fund operations, their ongoing financial viability depends primarily on its ability to attract and retain students. Charter schools can not levy property taxes and, in most cases, do not receive capital funds from the state. While their status as public schools prohibits the charging of tuition, some charter schools offer additional fee-based programs to augment revenues.

Moody's expects continued growth in the number of charter schools, which has expanded significantly from 100 schools in 1995 to more than 3,600 currently. Continued political support at the local, state and federal level; the passage of authorizing legislation in additional states; strong parental demand; and enhanced charter school legislation and funding will likely support continued expansion. At present, 40 states have enacted charter school legislation in addition to the District of Columbia and Puerto Rico. Some states with existing legislation continue to enhance legal and funding support for the operations and capital needs of local charter schools. Beginning in 2002, federal funding was also made available to a number of charter schools. To date, roughly $124 million has been appropriated under the federal Credit Enhancement for Charter School program to leverage around $1.4 billion in financing for charter schools. This is in addition to the State Charter School Facility Incentive Grants Program (which requires a state match) initiated in fiscal 2004, under which approximately $36 million has been awarded as well as another $1 billion in federal funds spent on charter school start-up grants over the last five years.

Moody's current portfolio of charter school ratings includes nine individual charter school financings and two pooled financing structures with a total of 19 participating schools. Our ratings range from A3 to B3 with a median rating of Ba1. Only three of the nine charter schools are currently rated in the investment-grade categories. The relatively low ratings for charter schools compared to most other municipal sectors reflect the relatively small size and narrow financial margins of most of the rated charter schools. Total rated debt approximates $205 million.

Moody's expects the following trends will have a positive impact on the credit quality of the charter school sector:

1. **Industry maturation** - Overall industry maturation, as evidenced by the growing number of charter schools with operating histories exceeding five years. Alliances with management companies and preexisting non-profit organizations provide important support to newer or highly leveraged enterprises.
2. **Growing enrollment levels** - Enrollment growth can be linked to augmented parental acceptance of charter schools as a viable and cost-effective educational alternative. Absolute headcount nationwide has more than doubled over the last five years - from an initial 300,000 children to close to over 635,000 in 2004 (the most recent year for which data is available). This contrasts sharply with growth in traditional public school enrollment, which is estimated at 4% over the last five years. Charter school enrollment, however, remains modest at approximately 2% of total public school enrollment, up significantly from 0.6% in 2000.
3. **Continued political support and improved oversight -** Local, state and federal support for charter schools remains stable, correlating with the political vision of charter schools as a potential remedy to inter- and intra-district academic disparities. Local support tends to mirror the needs of the home school district and is particularly strong in large urban areas with overcrowded facilities and in growing areas with insufficient building capacity. Oversight of charter schools by states and local authorizers also continues to improve incrementally, with consistent standards and early intervention considered key in supporting credit quality.

Moody's expects the following issues may continue to challenge the charter school sector:

1. **Limited capital funding -** Funding for capital needs is expected to remain limited for charter schools. Charter schools must continue to fund both operations and capital needs largely with state operating aid, a reality that is expected to continue to pressure financial operations.
2. **Narrow financial operations** - Moody's expects the financial operations of many charter schools to remain narrow. Narrow reserve positions are expected to continue given the limited resources available and the priority management must place on providing programs that attract students. Schools that develop successful grant-writing and/or fundraising programs will fare better than those that rely solely on state operating aid.
3. **Event risk and often inexperienced management** - Event risk and frequently small or inexperienced school management teams will likely continue to challenge the charter school sector. Examples of event risk common in the sector are significant declines in enrollment following increased competition or construction delays. An incident on campus, such as a student altercation or controversy regarding curriculum, could also lead to enrollment declines, which are highly correlated with financial performance.

Rating Methodology: Key Rating Factors for Charter Schools include Qualitative and Quantitative Measures

Our fundamental analytical framework includes an assessment of five key rating factors and 17 sub-factors:

1. Market Position
   - Enrollment Trends and Projections
   - Competition and Educational Alternatives
   - School Size
2. Governance and Management
   - Institutionalized Management
   - Composition and Role of Board of Directors
   - Use of Private Management Companies
3. Financial Position and Performance
   - Operating Performance/Debt Service Coverage
   - Budgeting
   - Financial Reserves/ Balance Sheet Flexibility
   - Extent of leveraging
4. Covenants and Legal Framework
   - Additional Bonds Test
   - Debt Service and other reserves
   - Mortgage Lien
   - Flow of Funds
   - Coverage Related Covenants
5. Charter and State Specific Credit Factors
   - Quality of Charter School Oversight
   - Charter Renewal Risk

1. Market Position

Moody's believes that understanding the market position of a charter school's service area is critical to assigning a charter school bond rating. Because charter school funding is calculated on a per-pupil basis there is a strong correlation between enrollment level and fiscal solvency. The ability of a charter school to meet enrollment targets may be a particularly important rating factor as many schools need to expand enrollment in order to meet future debt service requirements. Therefore, it is of particular importance to Moody's that management has a clear understanding of the potential student pool and a firm grasp on the minimum number of students to be enrolled at a particular school. To capture these dynamics in the credit evaluation, Moody's focuses on the total available school age population within a clearly defined service area (this can include the local school district, county, or wider geographic areas within commuting distance), philosophy toward education and commuting patterns. Moody's evaluation includes:

- **Enrollment Trends and Projections -** Enrollment trends and projections are a key input in charter school analysis given the tight correlation between enrollment levels and financial viability. As such, the ability to consistently meet enrollment projections is an important credit factor-and one that can not be fully evaluated in schools with a limited operating history. To quantify expectations of growth or stability, it is important to project population dynamics such as anticipated new residential growth and expectations of future migration. The extent to which a school will have to increase enrollment to attain the minimum number of students necessary to meet operating needs and debt service obligations compared to current enrollment levels is a key credit consideration. A well-demonstrated pattern of steady enrollment growth that meets or exceeds projections represents a key factor in supporting stronger credit quality. Those schools whose multi-year financial projections reflect the need to significantly increase current enrollment levels to cover average annual debt service requirements generally are considered of lower initial credit quality than those for which no enrollment growth is required. Declines or fluctuations in enrollment during a charter school's early years or enrollment growth that falls short of projections during subsequent years can suggest weakened credit quality.

- **Educational Alternatives** - Educational alternatives including the quality and type of programs offered by local public schools, other charters, private schools and home schooling are a credit factor. Given the inherent correlation between enrollment and revenues it is imperative to identify the realistic educational alternatives in the case of charter school dissatisfaction. Expectations for enrollment growth are enhanced in areas in which educational alternatives are poor; conversely, strength of the local traditional school can correlate negatively with charter enrollment stability if the charter runs into difficulties.
- **School Size** - Moody's is often asked if a minimum student enrollment figure is necessary to achieve an investment grade rating. While no absolute threshold exists, the three schools Moody's rates investment grade have an average enrollment of over 1,000 students, which is well above average for Moody's total portfolio of rated charter schools. In schools with enrollment below these levels, the loss of even a few students can negatively impact debt service coverage. At minimum, a school should comfortably be able to lose between 25 and 50 students with no significant impact on debt service coverage levels. In certain cases, the debt of smaller schools has achieved investment grade ratings through pooled financing structures.

2. Governance and Management

Charter schools may be created for any number of reasons and managed by individuals with varying degrees of management or educational experience. In assessing the governance and management of a charter school, Moody's considers the following factors:

- **Institutionalized Management -** Institutional management strategies that transcend any one individual enhance credit quality of charter schools. Moody's views adoption of policies, as well as a track record of adherence to these policies, guiding financial management, procurement, human resources, risk management (including minimum liability and property insurance levels) and other management objectives favorably. In charter schools, power is often centered with the individual who initiated the charter and the management of the school is highly leveraged. For example, the finance officer may also be the math and science teacher while someone else may be the charter holder, chief academic officer and the social studies teacher. While this structure may reduce salary expenditures and demonstrates staff commitment, it is a structure that can pose a challenge to a school if one or more key personnel choose to leave. To prepare for such a possibility, Moody's believes that a charter school should maintain transition plans to protect day-to-day operations should it experience the loss of key management personnel.
- **Composition and Role of Board of Directors -** Moody's believes a strong, independent board of directors provides critical oversight in light of the often thin staffing levels of most charter schools. We view an independent and diverse board that serves in an advisory capacity and provides additional oversight of day-to-day management as a positive credit factor. A strong board, in Moody's opinion, should include representatives from the community with various areas of expertise (the law, finance etc.) and a legal construct that delineates, at a minimum, the role of the board, voting powers, election of officers, term, duration and procedures for replacement of members.
- **Use of Private Management Companies -** Many charter schools choose to retain charter school management companies. Moody's analysis considers the use of management companies on a case-by-case basis, and does not specifically correlate use of a management company to a specific rating outcome. It is important to note, however, that in the event a management company is used, Moody's will review the terms of that contract to evaluate the risk to the charter school in the event the relationship is terminated by either party. Moreover, Moody's believes it is critical that the school's staff and board of directors remain involved in financial management issues and are actively reviewing results, setting objectives and providing oversight of the external management company's results - just as they would in the absence of a management contract.

3. Financial Position and Performance

In Moody's analysis of a charter school finances, we assess a number of quantitative measures of historical and projected financial performance. But we also seek to understand the institutionalization of financial strategies and planning, as well as a school's ability to react to shifting budgetary or demographic projections. Our analysis focuses on four areas-operating performance/debt service coverage, budgeting practices, financial reserves/balance sheet flexibility, and extent of leveraging.

- **Operating Performance/Debt Service Coverage** – Moody's measures operating performance and debt service coverage quantitatively through various measures including: (1) operating cash flow margin; (2) current year net revenues vs. current year debt service; (3) current year net revenues vs. maximum annual debt service; and (4) enrollment needed to achieve coverage of maximum annual debt service based upon current per-pupil state aid levels. Operating performance of charter schools is highly correlated with enrollment levels and budgeting practices. A minor error in enrollment projections can result in a significant financial impact, especially when schools do not budget contingencies or are limited in size such that mid-course correction (increasing class size, reducing staffing levels, eliminating programs) is difficult.

- **Budgeting Practices** – Budgeting practices that facilitate the ability to react in a timely manner to budget variances and projected demographic shifts in order to meet fiscal objectives are an important credit consideration. In some cases, charters have been generally successful at augmenting their per-student revenues by obtaining grant money and charitable contributions (in the form of land and buildings, and donations from individuals and corporations) as well as providing tuition-based programs such as full-day kindergarten or before- and after-school care. Budgeting to actual performance and meaningful multi-year budget forecasting represent two critical components of our analysis. In addition, we seek to understand a school's fiscal management strategies, goals and objectives.
- **Reserve Levels/Balance Sheet Flexibility -** Reserve levels and policies dictating the maintenance thereof, are an important component of our review of a charter school's finances. Debt service reserve funds are excluded from this portion of the analysis, as are other forms of restricted reserves. We seek to assess the charter school's ability to manage unforeseen circumstances (i.e. fuel cost increases, enrollment declines, state aid cuts) through cash on hand. Unrestricted cash balances, as a percent of the school's operating budget, provide an important measure as does the quick ratio (compares the availability of a school's most liquid assets to current liabilities) and the current ratio (compares current assets to current liabilities). Moody's assessment of balance sheet flexibility includes a review of unrestricted financial resources to operations (assesses balance sheet flexibility relative to annual operations).
- **Extent of Leveraging –** Moody's assesses the extent of leveraging through two measures: (1) unrestricted financial resources to debt (measures coverage of debt by the most liquid financial resources) and (2) the ratio of long-term debt to net capital assets and debt service as a percent of operating revenue. We also consider the school's capital needs, the likelihood (and feasibility under legal documents) of future leveraging, and the impact of any additional borrowing on debt and coverage levels.

4. Covenants and Legal Framework

Moody's analysis of the legal structure that supports repayment expectations of a charter school is a critical input in charter school credit quality. Various legal structures can inherently strengthen or weaken expectations of debt repayment given charter viability or of investment recovery in the case of a school closure or failure to meet debt service obligations. In addition, scrutiny of legal covenants that support or minimize additional parity obligations, thereby protecting net pledged revenues from dilution, is critical. Given the fundamental importance of the legal analysis, Moody's focuses on:

- **Additional Bonds Test (ABT)/Restrictions on Future Debt Issuance** - Moody's views as a strength an ABT that limits the extent to which the school can issue additional parity debt that may dilute the credit quality of the original rated issue. Although the specific ABT will vary from security to security, it is typically quantified through the limitation of additional debt if repayment of the new obligations would reduce coverage of total debt service by net revenue below a certain level — for example 1.50 times. The additional bonds test may be multi-tiered to factor in current coverage as well as forecasted coverage given enrollment growth projections. The closure of the lien, eliminating the possibility of future debt, or a more restrictive additional bonds test in the case of a more risky venture can provide some enhancement to credit quality. In some cases, bond documents have included limitations on operating debt, cash flow borrowing and subordinated debt as well.
- **Required Debt Service Reserve Funds (DSRF) and Working Capital Requirements** - A DSRF is an important credit component and is typically sized at maximum annual debt service and funded at closing with bond proceeds. The presence of a fully-funded DSRF provides investors with repayment continuity if revenues fall short of expectations or, in the case of a school closure that is not immediately followed by an asset sale, to cover debt service until the asset is sold (provided the asset is sold before the DSRF is drained). Strong provisions in legal documents also include a mechanism to replenish the DSRF in a timely manner in the event it is drawn down outside of a school closure. Pooled transactions often have additional cross-collateralized reserves and/or supplemental reserve funds that may enhance credit quality. Bond documents may also directly address requirements for additional cash and capital reserves, thereby providing stronger security. In some cases the covenants are very general, requiring the school simply to have on hand suffi-

cient cash to meet some of its key ongoing expenditures, such as salaries. More specific covenants have been designed requiring cash to be set aside in amounts measured in terms of either operating expenses or gross revenues. As the facilities housing charter schools are key both to the school's operations and to bondholder security, strong bond covenants emphasize funding for capital repairs and replacement. The repair and replacement funds are intended to be segregated from the school's other funds, and in some cases bond covenants have called for the establishment of a separate account, either at a commercial bank or with the bond trustee.

- **Mortgage Lien** - Given the inherent risk that a charter school can close or fail to satisfy debt service requirements, Moody's analysis factors the value of the pledged asset, typically a school plus a debt service reserve. We also consider area zoning regulations and potential for re-use of the site to assess the likelihood that a market for the property will exist in the event it must be sold to repay bondholders.
- **Flow of funds** - Because charter funding does not typically benefit from a discrete capital component, debt service expenditures may compete with other school-spending priorities. Therefore, Moody's takes a favorable view of a legal flow of funds that ensures that revenue flows directly from the state to the trustee for debt service payments. This is not always possible, however, as some states require that the funds flow first to the chartering entity and then to the trustee before flowing to the charter. Conversely, a much weaker payment method in Moody's view is a structure in which funds are remitted to the local school district without a date by which the funds must be transferred to the charter or its trustee. This flow is evident in New York and Pennsylvania and can result in significant funding delays, particularly if local support for charter schools is lacking.
- **Coverage related covenants** - Moody's analysis of coverage ratios and covenants as discussed previously is recognition of the fact that, unlike issuers of traditional revenue bonds, charter schools can not raise rates when coverage levels narrow and must proceed cautiously. Some credit comfort may be derived from legal covenants requiring a school to increase enrollment (where permitted by charter), if it is reasonable to expect this increase can be achieved in the event coverage dips below a certain level. Legal requirements regarding expenditure controls in the event coverage narrows would also be considered a credit positive.

5. Charter and State Specific Credit Factors

Charter schools are legal in 40 states, the District of Columbia and Puerto Rico, and the legislative framework delineating oversight and charter assignment varies tremendously in terms of reporting requirements, academic expectations, and renewal process. Therefore, our analysis includes an evaluation of the legal framework of the state in which the charter school is located, the authorizing entity as well as the oversight requirements that stem from each.

- **Quality of Charter School Oversight -** Five characteristics of strong oversight are:
  - The oversight role is clearly defined.
  - Oversight requires regular, audited financial reporting according to a specified timetable.
  - The oversight role supports proactive behavior in reviewing charter school finances and academic standards, more than once a year.
  - The oversight entity is permitted to review operating procedures, including fiscal policies.
  - The oversight entity can provide a greater allocation of personnel or financial resources to a charter school that runs into temporary academic, fiscal or management hurdles.

  In Moody's opinion, a cooperative relationship between the charter and the chartering entity (whether a university, the local school district, or the state), is a critical component in meeting the challenges faced by charter schools. This is because these entities are often empowered to provide critical guidance and resources especially during a charter school's early years of operations. Furthermore, these organizations may also be the principal provider of oversight for the charter and therefore can play a key role by intervening to help address underlying problems of a charter experiencing difficulties before these problems require a school censure or closure. Conversely, if there is ambivalence or lack of support by the chartering entity, early signs that the charter school may be experiencing financial or academic distress may go unmonitored or undetected or may, without a remediation period, provide the basis for charter revocation. Moody's believes that the ability of a charter school to open and then close or never open, as has been demonstrated repeatedly across the nation, reinforces the critical nature of having adequate and experienced oversight. It is important to acknowledge that the charter school movement views closure of poorly performing charter schools as evidence that the charter school movement works — a factor that is incorporated in our analysis of the sector as a whole as well as that of individual schools.

- **Charter Renewal Risk** - Charter schools typically issue debt that matures in 20 to 30 years and an initial charter period often extends only three to five years. Given charter renewal risks, Moody's evaluates the following three factors to gauge prospects for probable charter renewal:
  1. *Clearly delineated renewal criteria* - A charter contract with clearly delineated renewal criteria allows the evaluation of specific criteria that will determine probable charter renewal. In most states, the charter should be renewed if these indicators are being met . It is important to note that, in most states, a charter may be terminated at any time for violation of a charter contract, although, to date, we have seen charters revoked primarily for gross fiscal mismanagement.
  2. *Clearly outlined timing and appeal process* - The legislative framework for renewal should clearly delineate the timing of the renewal process, the possibility of transferring the charter to another sponsor, and timing and intermediate steps of the appeal process either with the state or in the courts. Under the strongest legislative frameworks, if a charter is not renewed, the mechanics of the renewal process provides adequate time for the charter to find another sponsor or appeal the revocation while allowing for continued operation until the final decision is reached. In the weaker frameworks, the appeal must be done through the courts, and the timing does not allow for a charter to maintain operations in the interim.
  3. *Political support* - The level of political support is reviewed at the state and local level. California, Arizona, Colorado, Texas, Florida, Minnesota and Michigan are among those states that Moody's views as demonstrating the strongest support. Charter school support on the local level tends to be very strong in large urban school districts where the charter school is typically strongly embraced by the parent body, and in growing areas where school districts struggle to meet capital needs.

Anatomy of An Investment Grade Charter School

An investment grade charter school satisfies the majority of the criteria described below. A school may be moderately deficient in one or more credit factors, however, if these deficiencies are offset by strengths in other areas. A below investment grade charter school would be notably deficient in one or more of these credit factors.

Market Position

1. A minimum 5 year history of stable or growing enrollment that is in line with budgetary projections; no need to grow enrollment to meet debt service costs
2. Offers a curriculum that is either not offered in surrounding school district or has a history of being considered a superior educational alternative to traditional public schools and competing charter schools; may be a part of the public school district's strategy to provide adequate educational capacity assuming enrollment levels are not expected to decline
3. School size-enrollment has historically been sufficient to cover debt service and operating costs as well as provide for accumulation of operating reserves; minimum enrollment approximates 750 students

Governance and Management

1. Management policies and practices are institutionalized through board adopted documents, which guide all aspects of financial, debt and risk management
2. Staff members are cross-trained so that transition is smooth in the event of loss of key personnel
3. The board is comprised of professionally diverse individuals, whose relative areas of expertise (law, finance, education etc) provide a good background for their role, not involved in the day to day management of the school who not only provide the policy direction but who also provide another layer of ongoing oversight; Board member qualifications, tenure and replacement process are adopted policies

Financial Position and Performance

1. Operating Performance
   - Current year debt service coverage of at least 1.25x to 2x (based on current year net revenues) with higher coverage levels expected of schools with lower enrollment levels
   - No enrollment growth needed to achieve maximum annual debt service coverage; in event maximum annual debt service is reached within five years, coverage in excess of 1.25x-2x (based on current year net revenues) with the greater coverage levels expected of schools with lower enrollment levels

- Operating Cash Flow margin between 5-10% at a minimum.

2. Budgeting Practices
   - Budget includes an annual contingency factor
   - Enrollment as well as all operating revenues and expenditures are conservatively projected based on historical growth rates
   - Strong track record of budget to actual performance
   - A track record of at least monthly budget oversight with expenditure modifications made as needed to ensure structurally balanced operations
   - Board apprised of budget assumptions as well as mid year financial projections
3. Reserve Levels
   - Policies maintained dictating reserve level minimums
   - Unrestricted cash balances as a % of a schools operating budget range from 20%-40% at a minimum with greater balances expected at schools with lower enrollment levels
   - Quick ratio between 200% and 300% with higher levels expected at schools with lower enrollment levels
   - Current ratio exceeds 150% to 250% with higher levels expected at schools with lower enrollment levels
4. Extent of Leveraging
   - Long term debt to net capital assets ratio is less than 100%
   - Debt service as a % of operating revenue is less than 15%

Covenants and Legal Framework

1. Additional Bonds Test/Restrictions on Future Debt Issuance
   - Lien is closed; no parity debt permitted
   - Operating and subordinated debt are also limited
2. DSRF/Working Capital Requirements
   - Standard three prong debt service reserve fund
   - Mechanism to refill debt service reserve if it is tapped with first available monies (subject only to debt service set asides)
   - Working Capital requirement of three months of operating expenditures
   - Capital reserve contributions made annually to provide for ongoing capital costs
3. Mortgage Lien
   - Value of the pledged asset (which is in a desirable location without strenuous zoning restrictions) plus the debt service reserve fund exceed 1.25 times debt outstanding
4. Flow of funds
   - State aid is paid directly to the bond trustee who deducts amounts due for debt service before remitting the remainder to the school
5. Coverage related covenants
   - In the event debt service coverage falls below predetermined levels, management will immediately report to the board and pursue cost containment measures as well as look to grow enrollment (if feasible).

Charter and State Specific Credit Factors

1. The five characteristics of strong oversight are in place
2. The chartering entity has clearly delineated charter renewal criteria and outlined timing and appeals process
3. Charter schools enjoy political support in the community and state

Conclusion

Once a charter school has received an initial rating, Moody's continues to monitor its credit quality over the life of the bonds. Like our initial analysis, our subsequent reviews also incorporate the five key credit elements presented in this report. These reviews reflect not only information obtained from audited financial results but also from discussions with school officials on operational and financial trends as well as any changes in funding or legislation at the local and state levels. At a minimum, timely disclosure of operational information and audited finances, as required in bond covenants and lease agreements, is required to assess credit quality.

Moody's anticipates continued growth in the charter school sector-both in terms of the number of schools as well as the amount of debt issued by charter schools. This expectation reflects industry maturation, enrollment growth, and continued political support at the local, state and federal level. The below-investment grade Ba1 median rating of charter schools reflects the risks inherent in charter school financings that, we believe, may be reduced over time as the rated schools establish greater trends of stable operations. Moody's also believes that the likelihood of event risk may moderate over time as schools become entrenched in their communities, complete construction projects and enrollment ramp-up periods and have longer operating and management histories.

Related Research

Rating Update:

Moody's Confirms Ba3 Rating With a Negative Outlook of Maricopa County Ida (Az) Education Revenue Bonds And Removes From Watchlist For Possible Downgrade, April 18, 2006

New Issue:

Moody's Affirms Baa2 Rating and Assigns Negative Outlook To Colorado Educational And Cultural Facilities Authority Charter School Refunding Revenue Bonds (Cherry Creek Academy Project), Series 2001, June 14, 2006

Moody's Affirms The Ba1 Rating And Assigns A Stable Outlook To Colorado Educational And Cultural Facilities Authority Charter School Revenue Bonds (Frontier Academy Project), Series 2001, June 14, 2006

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Appendix 1

Moody's Rated Charter Schools

Name	Rating	Outlook
Colorado		
Cherry Creek Academy	Baa2	Negative
Frontier Academy	Ba1	Stable
Michigan Municipal Bond Authority		
Black River Public Schools	Ba3	Stable
Detroit Academy of Arts & Sciences	Ba1	Negative
Sankofa Shule	Caa3	Watchlist for Possible Downgrade
YMCA Service Learning Academy	Ba1	Negative
Minnesota		
Community of Peace Academy	Ba1	
Florida		
Florida State University Schools, Inc (issuer is City of Tallahassee)	A3	Stable
Texas		
Uplift Education (issuer is Beasley Higher Education Facility Corp)	Baa3	
Maricopa County IDA, Az Pool	Ba3	Negative
Tempe Prep. Academy		
Westwind Academy		
Omega Academy		
Foothills Academy		
American Heritage		
Arizona Montessori		
Challenge Charter School, Inc		
Pima County IDA, Az Pool	Baa3	Stable
Young Scholars Academy		
Kingman Academy of Learning		
International Studies Academy		
Stepping Stones Academy		
Paramount Education		
Academy with Community Partners		
Hearn Academy		
Dobson Academy		
Valley Academy, Inc.		
New School for the Arts		
Benchmark		
Academy of Tucson		

Appendix 2

Key to Moody's Charter School Ratios

- **Coverage:** (revenues - expenditures (net of interest and depreciation)) / current year debt service
- **MADs Coverage:** (revenues - expenditures (net of interest and depreciation)) / maximum annual debt service
- **Unrestricted Cash to Operations:** unrestricted cash (excludes any debt service related cash) / operating expenditures
  - Assesses available cash relative to annual operating costs
- **Unrestricted Financial Resources-To-Operations:** unrestricted net assets / total operating expenditures
  - Assesses balance sheet flexibility relative to annual operations
- **Operating Cash Flow Margin:** (unrestricted revenue (net of any revenue released from restrictions for capital) - total unrestricted operating expenditures (net of depreciation and interest)) / total unrestricted revenue revenues
  - Assesses annual operating flexibility relative to annual operations
- **Current ratio:** current assets (excludes restricted assets) / current liabilities (includes short term debt such as lines of credit and loans used for operating purposes)
  - Assesses the availability of resources to pay near term obligations
- **Quick ratio:** (cash + current investments) / current liabilities (would include short term debt such as lines of credit and loans used for operating purposes)
  - Compares the availability of the most liquid assets to pay near term obligations
- **Unrestricted Financial Resources to Debt:** unrestricted financial resources/total debt?
  - Measures coverage of direct debt by the most liquid financial resources
- **Long Term Debt to Net Capital Assets Ratio:** total long term debt / total capital assets net of depreciation
  - Assesses degree to which capital assets are financed with long term debt
- **Debt service** (all long term debt) **to operations:** debt service / operating expenditures (including debt service but net of depreciation and amortization)

Appendix 3

Rating Definitions

U.S. MUNICIPAL AND TAX-EXEMPT RATINGS

Municipal Ratings are opinions of the investment quality of issuers and issues in the US municipal and tax-exempt markets. As such, these ratings incorporate Moody's assessment of the default probability and loss severity of these issuers and issues. The default and loss content for Moody's municipal long-term rating scale differs from Moody's general long-term rating scale.

MUNICIPAL LONG-TERM RATING DEFINITIONS:

Aaa

Issuers or issues rated Aaa demonstrate the strongest creditworthiness relative to other US municipal or tax-exempt issuers or issues.

Aa

Issuers or issues rated Aa demonstrate very strong creditworthiness relative to other US municipal or tax-exempt issuers or issues.

A

Issuers or issues rated A present above-average creditworthiness relative to other US municipal or tax-exempt issuers or issues.

Baa

Issuers or issues rated Baa represent average creditworthiness relative to other US municipal or tax- exempt issuers or issues.

Ba

Issuers or issues rated Ba demonstrate below-average creditworthiness relative to other US municipal or tax-exempt issuers or issues.

B

Issuers or issues rated B demonstrate weak creditworthiness relative to other US municipal or tax- exempt issuers or issues.

Caa

Issuers or issues rated Caa demonstrate very weak creditworthiness relative to other US municipal or tax-exempt issuers or issues.

Ca

Issuers or issues rated Ca demonstrate extremely weak creditworthiness relative to other US municipal or tax-exempt issuers or issues.

C

Issuers or issues rated C demonstrate the weakest creditworthiness relative to other US municipal or tax-exempt issuers or issues.

Note: Moody's appends numerical modifiers 1, 2, and 3 to each generic rating category from Aa through Caa. The modifier 1 indicates that the issuer or obligation ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates a ranking in the lower end of that generic rating category.

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