THE BOND BUYER

Labeling charter school bonds as social comes with risk

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Although charter school bonds seem to naturally lend themselves to a social label, there are inherent risks to taking that step.

"One of the biggest questions that often come up is, what are the qualification requirements of being a social bond?" said Ryan Callender, partner, Squire Patton Boggs. "Unfortunately, there's really no one answer to that."

The comments came via a webinar on Tuesday produced by the Council of Development Finance Agencies. CDFA members are very often the organizations tasked with financing charter school construction.

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Charter schools are public schools operating independently from local school districts. As of 2022, 43 states have charter schools. In the late 1990's charter schools began issuing tax-exempt bonds that are typically secured by the real estate they occupy.

While the parameter for defining a social bond remains unclear, the motivation driving the labeling efforts often comes down to messaging and pricing.

"The hope was that there would be investors who are really interested in social bonds," said Mark Medema, managing director, Charter School Facility Center, National Alliance for Public Charter Schools.

"If you designated your bond as a social bond, you would attract those investors and if you're increasing the demand for the social bond, one would expect that would increase the demand for it and the pricing would be better."

Medema concedes that that a social designation can be lumped in with the contentious ESG debate, but charter schools have their own support base.

"In red states, ESG has become a political issue," he said. "Oddly enough, school choice is actually more favored in red states, so you might see that as a counterbalance, and those two might just knock each other out."

Labeling a bond as social, whether via a third party or self-applied, requires extra levels of disclosure for longer periods of time.

"There is a tendency, when you're trying to designate a social bond, whether it be a charter school or otherwise, to do a little bit of what I would refer to as puffery," said Callender. "We have to remember that when we are designating as social that comes under the exact same standards as all the other disclosure that you're providing to potential investors."

Issuing moral obligation bonds to fund charter schools is a strategy used by states or municipalities to back the bonds via a moral promise versus a legal obligation. They are especially popular in Colorado, Utah, and Idaho.

"It's not specifically a social designation, but it is another program that acts to provide a lower cost of capital to the qualifying charter schools," said Cory Phelps, VP project finance at Idaho Housing and Finance.

S&P Global Ratings tracks moral obligation programs offered through the three states. As of May 2024, Colorado accounts for 77 issuances totaling over a billion dollars, rated at A+/ Stable. Utah has issued 31 tranches for $525 million, AA/Stable. Idaho has 10 issuances for $93 million at A+/Stable.

Issuing bonds to pay for building and / or operating charter schools reached a high water mark in 2021 when market forces pushed $5.55 billion of issuance into the sector. Demand has since fallen back with 2023 accounting for $2.83 billion according to analysis via Municipal Market Analytics.