

Illinois Finance Authority UNO Charter School Network; Charter Schools

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Credit Profile		
US\$35.85 mil charter sch rfdg & imp rev bnds (UNO Charter Sch Network) ser 2011A due 11/01/2041		
<i>Long Term Rating</i>	BBB-/Stable	New
US\$0.495 mil charter sch rfdg & imp rev bnds (Uno Charter School Network, Inc. Proj) taxable ser 2011B due 11/01/2041		
<i>Long Term Rating</i>	BBB-/Stable	New

Rationale

Standard and Poor's Ratings Services assigned its 'BBB-' rating to Illinois Finance Authority's charter school refunding and improvement revenue bonds series 2011A and taxable series 2011B issued for UNO Charter School Network (UCSN). The outlook is stable.

The ratings is based on our view of:

- The risks associated with any charter school;
- Considerable growth risk with two schools opening this month (September 2011) although they are fully enrolled, and an additional six new schools slated to come on line in the next two years with facilities not yet identified;
- Deficit operations and unrestricted net asset position in fiscal 2010 for UCSN due to overall growth, debt structure, and operations, somewhat mitigated by preliminary 2011 results that show a surplus due to grant money and expense managements; and
- Slim coverage of maximum annual debt service (MADS) of about 1 time (x) in budgeted fiscal 2012 that does not subordinated management fees and assumes the operations and debt associated with the two schools under a different pledge that are not on parity.

The rating is further supported, in our view, by:

- Two successful charter renewals;
- Wait lists at all schools and room to grow at many of the locations;
- State appropriation of \$98 million to construct schools, \$30 million of which is already expended;
- Good cash position, with UCSN having 128 days' cash on hand at June 30, 2010 and about the same estimated for fiscal 2011;
- Security that includes the guaranty of the closely affiliated organization, United Neighborhood Organization (UNO), which acts as the charter management company and owner of properties; and
- A seasoned management team.

The bonds are secured by a gross revenue pledge of nine of the 11 charter schools currently in the network as well as six schools that are expected to come online in fall 2012 and fall 2013. At least two of these six schools are expected to be built with a \$98 million state of Illinois appropriation. In addition, UNO, owner of five schools (including two schools that are not part of this pledge or guaranty) and the management company, is a guarantor of the bonds.

Since the majority of UNO's revenues are from UCSN, we view the two closely affiliated entities as one.

UCSN has about \$65 million of debt outstanding and will have a bit more (about \$67.8 million) after the transactions. We understand that the \$35.9 million series 2011A and \$495,000 series 2011B bonds will refund part of a bank loan (about \$30.4 million) and an Illinois Finance Fund loan (\$900,000). About \$800,000 will be used for improvements on one campus. There is a debt service reserve fund, and covenants include an additional bonds test of 1.1x of existing debt and 1.2x of projected debt, as well as a covenant that UCSN will have 70 days of cash on hand at the end of every fiscal year. In addition, a custodial agreement has the trustee receiving quarterly payments from Chicago Public School (CPS) for all UNO charter schools and from the nine schools (currently) securing the 2011 bonds, making payment to the various bond funds, and forwarding the remaining funds to UCSN. If CPS payments are not sufficient to cover debt service, other UCSN revenues may be used, including revenues from the two schools that are not pledged. If these revenues are still not sufficient, UNO's guaranty takes effect.

In addition, we understand that UCSN will refund \$12.8 million of the bank loan through a Local Initiative Support Corp. (LISC) financing that, at the end of its eight-year term, is expected to be partially forgiven (\$2.8 million) through New Market Tax Credits; Standard & Poor's will not rate this transaction. That financing is expected to be secured by two schools that are not part of the series 2011 gross pledge. Also, the outstanding approximately \$18.7 million of the bank loan is expected to be refinanced by Oct. 1, 2012. This outstanding bank loan is on parity with the series 2011 bonds, and its debt service is included in calculations. UCSN may issue additional debt in the next few years in connection with expansion. Although the two schools not securing the bonds with their debt and operations, are not in the master trust indenture (MTI), we view the entities as part of a system and, therefore, include them in our calculations.

Management fees are subordinate to both the series 2011 bonds and the LISC financing although we include them in coverage ratios because these fees are a part of operations. Series 2011 debt service is expected to be level at about \$2.7 million; in addition, the bank loan that is expected to be refinanced in 2012 has level debt service at about \$1.2 million. Currently, lease payments are about \$855,000 a year but, with the addition of schools by 2014, will rise to about \$2.1 million with slight annual increases. The LISC new market tax credit deal, not included in the MTI, has about \$1.2 million in debt service, making MADS an estimated \$7.9 million (in fiscal 2019), providing an estimated 1.3x coverage in fiscal 2011 (adjusted for one-time expenses, though this may be overstated with one-time grant money). MADS coverage in 2012 is projected to be 1.04x. The carrying charge, at 20.9%, currently is high although budgeted pro formas show it moderating to 12% in fiscal 2017 once the new schools are opened.

Outlook

The stable outlook assumes improved operations on an audited basis, continued ability to cover debt service and MADS, continued strong enrollment, and growth as planned. Continued audited deficits and slowed growth in the next two years could place pressure on the rating or the outlook. Positive rating or outlook movement is unlikely during the two-year outlook period; however, positive rating factors could include a return to positive unrestricted net assets, successful refinancing of the outstanding loan portion, and the opening of the schools as planned.

Organization

UNO was incorporated in 1984 as an Illinois non-profit 501(c)3 organization to provide outreach and social services to Hispanics in Chicago. As part of its mission, UNO started to focus on education. In 1998 UCSN was incorporated as a closely affiliated organization to UNO to operate a charter school. Since then, the charter has been renewed twice and runs through June 2013. Currently 11 schools operate under the charter with no limit on the number of schools that may be opened under the charter although the Chicago Board of Education has to approve each school, and each school has an enrollment cap.

UNO has managed the schools of UCSN since 2000 through a management agreement. The current management agreement was executed in October 2010 and runs through 2015. The management fee is not to exceed 10% of UCSN's audited unrestricted revenues, excluding interest income, contributed services, and fundraising. In addition, UNO owns five of the schools and leases them to UCSN. On average, more than 80% of UNO revenues are from UCSN.

Both organizations have the same five board members (although with differing functions on each board). It is our opinion that management is prudent about growth and knowledgeable about how city and state funding operates. The person who is CEO of UNO and chair of UCSN has been involved with UCSN since its inception. New senior management, including a chief operating officer, finance director, and compliance manager, has been added in the last couple of years to facilitate growth plans. We view these closely affiliated organizations as one.

USCN

Ten of the 11 USCN schools are grades kindergarten through eight (K-8), and there is one high school (grades nine through 12). The majority of students are English learners, and the schools' philosophy is language immersion. Estimated enrollment at each school ranges from 275 students to 638 for fall 2011. All but one of these schools has at least a 10% waiting list although most schools' lists are more than 50% of enrollment. Estimated enrollment of the 11 schools for fall 2011 is 5,425, with a capacity of 6,390. Each school has a separate application process, and schools are open to all residents of Chicago. Included in these statistics are the two schools that are not included in this pledge. They have estimated enrollment of 1,138 with a capacity of 1,260. More than 95% of students qualify for free lunch. The retention rate is very good, at 90% or better. Most schools' English and math scores tend to be a few percentage points above the district's scores although when compared to neighborhood schools with similar demographics and English learners, reading scores tend to be at least 50% higher. Properties not leased are owned by UNO, and UNO has long-term leases for rented properties. Two schools of the 11 opened this month (September 2011).

In general, public schools in Illinois are funded about half from local sources, a third from state sources, and the remainder from federal money. In fiscal 2010, per pupil base funding, as determined by the state, was \$6,119 but was \$5,873 in fiscal 2011. It is expected to be the same amount this year (fiscal 2012). Overall, USCN students received more than that due to other categorical amounts of funding that averaged an additional \$725. None of CPS' payments to UCSN have been late.

Growth

The Chicago Board of Education has approved the opening of three additional schools for fall 2012, and applications have been filed for an additional three schools for fall 2013. Five of these schools are expected to be elementary schools with one high school. Physical facilities have not yet been identified. However, these six

approved and pending schools are included in the security for these bonds, under the MTI. We are counting in our projections only the three schools that are approved for opening in fall 2012. Funding for at least two of these schools is expected to come from a \$98 million state appropriation, granted in 2009 to UNO, to construct new school facilities. To date, UNO has received \$30 million and has used \$5 million to complete construction on three schools and \$25 million to construct the Soccer Academy (grades K-8), opening this month (September 2011). In addition, UCSN receives grant money of about \$1 million annually from philanthropic organizations for both new construction and ongoing programs. UNO also receives modest grant money and fundraises for programs that are not affiliated with the charter schools. Beyond these considerable plans, management does not have further growth plans in the next three years. In preparation for growth, management has expanded its infrastructure with leadership, additional staff, and policies.

Operations

As part of the recent growth, UCSN has had operating deficits and subsequently negative unrestricted net assets (\$6.6 million as of June 30, 2010, the most recent audited year) in part due to non-cash rent recordings to UNO, the affiliated entity. The non-cash rent is basically principal payments on the outstanding debt. Since this debt is in the midst of being refinanced, the deficits will decrease; in addition, management has shared that for fiscal 2011, salaries were frozen, some maintenance was deferred, and there were furlough days. Thus, management has indicated that with increased revenue from student growth and grant money and expenses held, operations will be strong with an estimated \$4 million surplus, including \$1 million of depreciation and amortization expense.

UNO, the guarantor, who receives the majority of its income from UCSN, has historically posted surpluses. Its Dec. 31, 2010 audit shows an \$8.8 million surplus (unrestricted) in part due to grant money and state appropriations (for UCSN).

Both UCSN and UNO have historically had good cash positions. UCSN had 128 days' cash on hand in 2010 (audited), and management has estimated about the same amount in fiscal 2011. Likewise, UNO in fiscals 2008 and 2009 had about 69 and 50 days' cash on hand, respectively; however, it jumped to more than 400 days at Dec. 31, 2010 in part to grant activity.

Related Criteria And Research

USPF Criteria: Charter Schools, June 14, 2007

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