Colorado League of Charter Schools
PURCHASING OR BUILDING A NEW FACILITY? THE FINANCING OPTIONS & PREPARING FOR A FINANCING

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"I can’t sleep. I just got this incredible craving for capital."
Capital Financing Options: More Than Ever Before

Charter School

- Lease-to-Purchase
- CDFI Loan
- EB-5 Visa Loan
- Bank Financing
- Bond Financing
- USDA

Private Equity

REIT

Developer

Taxable

Tax-Exempt

District

School

Direct

Guarantee
Why do School’s Borrow to Fund Capital Projects?

1. To secure facilities for the future (escape landlord/lease demands)

2. Can be less costly over the long-term

3. Allows School to develop property programmatically

4. Allows school to generate equity in its facilities
Lease-to-Purchase

What is it? 3rd party is hired to build and own the facility and then enters into a lease agreement with the school. The School has an option to purchase the facility at a later date – typically in 2 to 5 years.

**Pros**
- Developer takes construction risk
- Developer typically willing to execute project for school in its infancy
- Allows school access to new facility early in life cycle
- Can have input on construction

**Cons**
- Typically the most costly option
- No equity being accrued during lease period
- Cost of acquisition tends to range from 115-130% of cost of construction
- Quality of construction can be substandard

**Bottom Line:** Can be a useful bridge to a permanent facility in some instances but expect to pay up for it
CDFI Loan

What is it? Community Development Financial Institution (non-profit) provides loan to schools for purposes of constructing facilities that fit within their mission

Pros
• Will finance schools in their infancy as well as “higher risk” financings
• Cost of capital can be low
• Certain populations are viewed very favorably by CDFIs leading to easier loan process and availability of funds

Cons
• Can be subject to maximum loan-to-value ratio requirement meaning school needs subordinate loan or equity/cash
• Typically can only loan up to $10 million – limited funds available
• Short-term bridge financing, requires takeout in 3 to 7 years

Bottom Line: Good option for certain schools to obtain access to a limited amount of financing which can serve as a useful bridge to permanent financing
EB-5 Visa Loan

**What is it?** Governmental program which allows foreign investors to provide subordinated loans to charter schools in return for a Green Card

**Pros**
- Will finance schools in their infancy as well as “higher risk” financings
- Subordinated to other loans
- Can make up for loan-to-value shortfalls (i.e. provide “equity”)

**Cons**
- School must create/increase certain number of jobs - typically cannot provide 100% of funding needed
- School must be located in qualified census tract
- Can take 6 months to close financing
- Short-term bridge financing, requires takeout in 3 to 5 years

**Bottom Line:** EB-5 can be a helpful tool for completing the capital stack for a financing, especially for start-up schools, but plan ahead because it can take time to complete financing
Bank Financing

What is it? Some banks have begun to provide loans for facilities to charter schools, predominantly in the form of tax-exempt loans

Pros
- Limited loan demand has led to attractive borrowing rates being offered to charters
- Some banks do not require the school to set aside a debt service reserve, reducing amount borrowed

Cons
- Bank term sheet does not always lead to bank commitment or terms can change substantially in commitment
- Subject to loan-to-value ratio requirement, requires equity or subordinate lender
- Financing typically 5 to 15 years, subjecting school to refinancing risk

Bottom Line: Banks will not finance schools in their infancy but have, in certain instances, provided attractive rates to mature charters with equity in their buildings
Tax-Exempt Bond Financing

**What is it?** A form of financing that charters, as non-profits/quasi governmental organizations, can use to fund capital projects – a syndicated loan

**Pros**
- Can finance 100% of project cost, no LTV requirements
- Commitment terms up to 35 years, no refinancing risk
- Interest rates continue to hover near historic lows
- More lenient covenants than other forms of financing, allows for future additional debt

**Cons**
- Bond financings typically require some operating history although there are a handful of national investors willing to provide financing for start-ups/expansions
- Typically higher cost due to commitment period
- Bonds are typically not callable for 10 years

**Bottom Line:** Bond financing provides low risk long-term capital to schools with operating history and the market continues to expand allowing more schools access to the market
The Bond Market Continues to Expand

- 818 charter school bond issuances dating back to 1998 totaling more than $10.4 billion
- 95 bond issuances in 2014 totaling $1.86 billion

Source: Local Initiative Support Corporation
USDA Loan

What is it? Schools located in rural areas (20,000 population or less) can obtain market beating loan from USDA to fund capital projects – two types of loans (i) direct and (ii) guarantee

Pros
• Direct rates offered can be below 4% for 40 year financing, way below market rates
• Guarantee program can be used to refinance existing debt
• Schools that may not qualify for other types of financing due to location/credit profile are provided access to financing

Cons
• Guarantee terms not as competitive, require lender of record to lend funds to school
• Direct program the most attractive but can only be used for new money projects and require interim bank financing
• Loan process can take 6 to 12 months

Bottom Line: USDA direct financing is the lowest cost financing available to charter schools, however obtaining it requires a competent team committed to the effort
Case Study: New America School

Financing #1
- Lease-to-Purchase
- Private Equity
- REIT
- Developer

New America
- CDFI Loan
- Bank Financing
- Taxable
- Tax-Exempt

Financing #2
- EB-5 Visa Investment
- Bond Financing
- District
- School
- BEST
- Private Foundation

Grant
Case Study: New America School

The Facts @ Time of Financing:

- Enrollment – 305 students
- Date Opened - 2005
- Authorizer – Colorado Charter School Institute (“CSI”)
- Population – English language learners, immigrants, free and reduced lunch
- Purpose of Financing:
  - School renting an insufficient facility from Mapleton School District
  - Wants to purchase/build facility nearby
  - Acquire Albertson’s approximately 2 miles north and renovate (cost ~$4 million)
The Risks @ Time of Financing:
• Movement of campus 2 miles – would students follow?
  – Transient enrollment made movement that much more of a risk
• Tight construction timeline – closed financing in May 2013 and needed facility open by January 2014

The Facts Today:
• Enrollment – increased from 305 to near 400 students
• Facility opened on time and on budget
• Student Satisfaction – Dramatically improved
• Financing #2 – Preparing for bond issuance in 2016 which is first possible opportunity to acquire facility from developer
Why was project successful?

• Planning – Executed comprehensive financial modeling process to stress-test for potential downside scenarios – led to objective discussions about the risks and ultimately decision to move forward with project

• Utilized services of experienced advisors:
  – Financial
  – Owner’s Representative
  – Bank
  – Developer
  – Equity provider

• Risk Mitigation:
  – Surveyed student population to determine willingness to follow school to new location
  – Aligned interest with developer’s to ensure project completed on time
Case Study: Why the Hassle of Financing #2?

- New America School is effectively borrowing at a rate of 12% currently and this increases over time.
- In the tax-exempt bond market the rate at which it could borrow is more like 5.5% and capital is committed for 30-years.
“O.K., folks, let's move along. I'm sure you've all seen someone qualify for a loan before.”
The 4 Keys to Obtaining Attractive Financing

1. **Cash is King** - a strong liquidity position is paramount to obtaining the most attractive financing terms
   - The August 2015 S&P BBB- investment grade median for days’ cash on hand is 111 days

2. **Operating Surpluses Key** – Pro-forma coverage in excess of 1.0x
   - Schools with a track record of cash flow predictability will obtain better terms

3. **Strong Educational Program** – Good test scores relative to peers and/or growth in student body achievement

4. **Plan Certainty** – Lenders despise uncertainty and prefer projects that improve finances of the school – know before you go
Ratings in the Bond Market

- About half of charter schools issue non-rated bonds and half obtain a rating from a rating agency. Charter School bonds typically fall into one of two rating categories, BBB or BB. The rating scale is detailed below:

<table>
<thead>
<tr>
<th>AAA</th>
<th>AA</th>
<th>A</th>
<th>BBB+</th>
<th>BBB</th>
<th>BB+</th>
<th>B+</th>
<th>CCC+</th>
<th>CC+</th>
<th>C+</th>
<th>Etc.</th>
</tr>
</thead>
<tbody>
<tr>
<td>AA+</td>
<td>A+</td>
<td>A+</td>
<td>BBB+</td>
<td>BB+</td>
<td>B+</td>
<td>CCC+</td>
<td>CC+</td>
<td>C+</td>
<td>Etc.</td>
<td></td>
</tr>
<tr>
<td>AA</td>
<td>A</td>
<td>A</td>
<td>BBB</td>
<td>BB</td>
<td>B</td>
<td>CCC</td>
<td>CC</td>
<td>C</td>
<td></td>
<td></td>
</tr>
<tr>
<td>AA-</td>
<td>A-</td>
<td>A-</td>
<td>BBB-</td>
<td>BB-</td>
<td>B-</td>
<td>CCC-</td>
<td>CC-</td>
<td>C-</td>
<td></td>
<td></td>
</tr>
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</table>

Investment Grade  Non-Investment Grade
The Most Important Rating Metrics

<table>
<thead>
<tr>
<th>S&amp;P Charter School Medians</th>
<th>BBB+/BBB</th>
<th>BBB-</th>
<th>BB+</th>
<th>BB/BB-</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>FY14</td>
<td>FY13</td>
<td>FY14</td>
<td>FY13</td>
</tr>
<tr>
<td>Enrollment</td>
<td>1,962</td>
<td>1,531</td>
<td>771</td>
<td>799</td>
</tr>
<tr>
<td>Lease adjusted annual debt service coverage (x)</td>
<td>1.7</td>
<td>1.6</td>
<td>1.5</td>
<td>1.36</td>
</tr>
<tr>
<td>Lease Adjusted MADS as % of state aid (%)</td>
<td>13.7</td>
<td>14.8</td>
<td>15.5</td>
<td>16.28</td>
</tr>
<tr>
<td>Lease adjusted MADS debt burden (%)</td>
<td>11.1</td>
<td>12.2</td>
<td>13.4</td>
<td>13.08</td>
</tr>
<tr>
<td>Unrestricted days' cash on hand</td>
<td>134</td>
<td>153</td>
<td>111</td>
<td>99</td>
</tr>
<tr>
<td>Unrestricted cash to debt (%)</td>
<td>35.9</td>
<td>27.5</td>
<td>18.1</td>
<td>15.85</td>
</tr>
</tbody>
</table>

- See Appendix A for definitions
Questions?

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Appendix A

Rating & Credit Characteristics of Charter School Bonds
Rating Overview
- As of May 31, 2013, Standard & Poor's had 187 public bond issue ratings and charter schools issuer credit ratings
- Between March 2012 and May 2013, Standard & Poor's assigned new ratings to 45 charter schools, close to half of which were in the 'BB' category
  - This distinctly reflects the continued growth of the overall sector and the expanding access to capital for charter schools

Rating Characteristics
- Over 96% of issuing schools that are Pre-opening – 3 years in age issued bonds as “unrated”
- Of the total outstanding charter school bond issuances, 49%, had no underlying credit rating at the time of issuance
- Of the offerings, 41% were assigned ratings in the BBB investment grade category
- 10% were assigned ratings in the “BB” non-investment grade category
Rating & Credit Characteristics (cont.)

- **Age of School**
  - Median school age at issuance: **6.4 years**
  - **20%** of the issuing schools age’s are from **Pre-opening – 3 years**
  - **24** of the outstanding bonds have been for schools that have not yet opened or the financing was executed during their first year in operation
  - **2/3** of the offerings for new schools were for schools that were charter networks. However, these issues were not secured by the parent organization or network.

### Issuance & Credit Characteristics by School Age

<table>
<thead>
<tr>
<th>Age</th>
<th># of Issues</th>
<th>Par Millions</th>
<th>Investment Grade %</th>
<th>Non-Investment Grade %</th>
<th>Unrated %</th>
<th>Enrollment</th>
<th>Waitlist</th>
<th>DSCR</th>
<th>Debt Burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-opening</td>
<td>15</td>
<td>$161.1</td>
<td>0%</td>
<td>0%</td>
<td>100%</td>
<td>0</td>
<td>Na</td>
<td>1.72</td>
<td>15.2%</td>
</tr>
<tr>
<td>0 - 1.0</td>
<td>9</td>
<td>$77.5</td>
<td>0%</td>
<td>0%</td>
<td>100%</td>
<td>390</td>
<td>62%</td>
<td>1.57</td>
<td>16.5%</td>
</tr>
<tr>
<td>1.1 - 2.0</td>
<td>24</td>
<td>$218.0</td>
<td>0%</td>
<td>4%</td>
<td>96%</td>
<td>420</td>
<td>39%</td>
<td>1.49</td>
<td>15.6%</td>
</tr>
<tr>
<td>2.1 - 3.0</td>
<td>29</td>
<td>$188.1</td>
<td>0%</td>
<td>10%</td>
<td>90%</td>
<td>377</td>
<td>29%</td>
<td>1.54</td>
<td>13.6%</td>
</tr>
<tr>
<td>3.1 - 4.0</td>
<td>36</td>
<td>$476.9</td>
<td>28%</td>
<td>8%</td>
<td>64%</td>
<td>484</td>
<td>33%</td>
<td>1.57</td>
<td>14.5%</td>
</tr>
<tr>
<td>4.1 - 5.0</td>
<td>26</td>
<td>$282.9</td>
<td>54%</td>
<td>12%</td>
<td>35%</td>
<td>595</td>
<td>32%</td>
<td>1.38</td>
<td>13.8%</td>
</tr>
<tr>
<td>5.1 - 7.5</td>
<td>73</td>
<td>$849.1</td>
<td>44%</td>
<td>15%</td>
<td>41%</td>
<td>554</td>
<td>49%</td>
<td>1.57</td>
<td>13.9%</td>
</tr>
<tr>
<td>7.6 - 10.0</td>
<td>74</td>
<td>$819.8</td>
<td>54%</td>
<td>12%</td>
<td>34%</td>
<td>626</td>
<td>39%</td>
<td>1.57</td>
<td>11.6%</td>
</tr>
<tr>
<td>&gt;10 Years</td>
<td>93</td>
<td>$1,813.0</td>
<td>69%</td>
<td>10%</td>
<td>27%</td>
<td>726</td>
<td>31%</td>
<td>1.65</td>
<td>12.8%</td>
</tr>
<tr>
<td>All</td>
<td>379</td>
<td>$4,686.5</td>
<td>41%</td>
<td>10%</td>
<td>49%</td>
<td>554</td>
<td>37%</td>
<td>1.53</td>
<td>13.4%</td>
</tr>
</tbody>
</table>
Rating & Credit Characteristics (cont.)

- **Waitlist**
  - Median waitlist percentage: **37%**
  - Of the **379** outstanding bond issuances:
    - **12%** of the issuing schools maintained waitlists equaling 100% or more of enrollment at issuance, while **26%** of offerings were between the 0% - 30%
    - A large number of waitlisted students is considered a credit strength because it is indicative of the school’s reputation and demand
      - Should a school lose students, it has the ability to draw from its waitlist to maintain enrollment and per pupil revenue
- **Enrollment**
  - Median Enrollment at issuance: **554 Students**
  - **58%** of the issuing schools have enrollment of **500 students or more**
  - **28%** of the issuing schools have enrollment ranging **between 250 – 499** students (the range for a typical stand along charter school)
  - Large enrollments are generally considered a credit strength, although bigger is not always better
    - Schools which grow enrollment solely in order to pay for their facility, rather than in response to the logic of their academic program, face other risk factors
  - **73%** of all defaulted bonds have been linked directly to poor academic performance, including failure to make “Adequate Yearly Progress” for at least the year in which the default occurred, thus shrinking enrollment
Rating & Credit Characteristics (cont.)

- **Debt Burden**
  - Of the outstanding bond issuances, **39%** had a debt burden of less than 10%
  - **68%** had a debt burden of less than 15%
  - **9%** had a debt burden of 20% or more
  - Schools with unrated debt tended to have a **higher** debt burden percentage
Rating & Credit Characteristics (cont.)

- Governance & Accountability
  - A school should have a board made up of both parents and other community members
  - A school should have both an executive director as well as a business manager/CFO
  - As required by Colorado law, a charter school should prepare audited financial statements annually

![Board Composition Diagram]

- Parents 50%
- Third Party Representatives 50%
## Glossary: Charter School Ratios

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lease adjusted annual debt service coverage (x)</td>
<td>(EBIDA + operating lease expenses) / (current debt service + lease payments for facilities + capital leases)</td>
</tr>
<tr>
<td>Lease adjusted MADS as % of state aid</td>
<td>100 X (MADS + lease payments for facilities + capital lease payments)/state revenues</td>
</tr>
<tr>
<td>Lease adjusted MADS debt burden</td>
<td>100 X (MADS + lease payments for facilities + capital lease payments)/total expenses</td>
</tr>
<tr>
<td>Unrestricted days' cash on hand</td>
<td>Unrestricted cash / ((total expenses – depreciation and amortization expense) / 365)</td>
</tr>
<tr>
<td>Unrestricted cash to debt (%)</td>
<td>100 X unrestricted cash / total long-term debt</td>
</tr>
</tbody>
</table>

Appendix B

D.A. Davidson Charter School
Facility Finance Group
Established in 1935, D.A. Davidson & Co. is a super-regional investment bank and is the largest full-service independent broker-dealer headquartered in the Western U.S. based on total financial consultants.

- In total, the firm has $43.39 Billion of assets under management
- The company’s roughly 1,310 employees work from offices in 25 states, in 87 locations, delivering financial services, recommendations and products
- D.A. Davidson is the #1 underwriter, based on number issues, of charter school bonds nationally
- D.A. Davidson’s Fixed Income Capital Markets Division, home of its Public Finance operations, is headquartered in Denver.
D.A. Davidson’s Commitment to Charter Schools

- Davidson has been focused on the borrowing needs of charter schools since 1998 when we executed our first charter school transaction. Since then we’ve executed more than 160 financings totaling $1.8 billion.

- Davidson is one of the most active charter school financiers in the country having done more financings than any other firm in the country through 2014.

- Recognized as a pioneer in the industry, our support and involvement has been instrumental in crafting legislation in Texas, Colorado, Utah, New Mexico, Nevada and Pennsylvania.

Source: 2015 LISC Study (D.A. Davidson total includes Kirkpatrick Pettis transactions as Davidson acquired Kirkpatrick Pettis in 2005)
# Recent D.A. Davidson Charter School Projects

<table>
<thead>
<tr>
<th>School</th>
<th>Date</th>
<th>Loan Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Academy</td>
<td>10/8/15</td>
<td>$38,790,000</td>
</tr>
<tr>
<td>Union Colony Prep School</td>
<td>06/19/2015</td>
<td>$7,140,000</td>
</tr>
<tr>
<td>North Star Academy</td>
<td>06/12/2015</td>
<td>$8,830,000</td>
</tr>
<tr>
<td>Somerset Academy</td>
<td>04/09/2015</td>
<td>$43,080,000</td>
</tr>
<tr>
<td>Stargate Charter School</td>
<td>04/08/2015</td>
<td>$50,415,000</td>
</tr>
<tr>
<td>University Lab School</td>
<td>03/26/2015</td>
<td>$29,630,000</td>
</tr>
<tr>
<td>Palmetto Scholars Academy</td>
<td>03/12/2015</td>
<td>$8,495,000</td>
</tr>
<tr>
<td>The Classical Academy</td>
<td>02/17/2015</td>
<td>$14,770,000</td>
</tr>
</tbody>
</table>

Source: D.A. Davidson & Co.
D.A. Davidson’s Execution is Superior

- D.A. Davidson has been in the charter school market since 1998, our team has financed over 160 schools. We believe our success is a product of client focus and passion for education. Clients gravitate towards Davidson because they want the lowest interest rate and the lowest costs of issuance.

- In 2012 the Local Initiative Support Corporation (LISC) did a study of all of the charter school bond issuances executed in calendar years 2011 and 2012 and determined that D.A. Davidson not only offered the lowest all-in interest cost of any underwriter but also the lowest costs of issuance:

<table>
<thead>
<tr>
<th>Underwriter</th>
<th># of Issues</th>
<th>Par Millions</th>
<th>All-In-Cost</th>
<th>Costs of Issuance (% of Par)</th>
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<tbody>
<tr>
<td>D.A. Davidson &amp; Co.</td>
<td>11</td>
<td>$98.8</td>
<td>7.19%</td>
<td>3.45%</td>
</tr>
<tr>
<td>RBC Capital Markets</td>
<td>11</td>
<td>$173.6</td>
<td>7.47%</td>
<td>4.36%</td>
</tr>
<tr>
<td>Piper Jaffray</td>
<td>9</td>
<td>$96.8</td>
<td>8.25%</td>
<td>4.62%</td>
</tr>
<tr>
<td>Baird</td>
<td>8</td>
<td>$194.8</td>
<td>7.28%</td>
<td>4.75%</td>
</tr>
<tr>
<td>Ziegler</td>
<td>7</td>
<td>$217.3</td>
<td>7.62%</td>
<td>3.64%</td>
</tr>
</tbody>
</table>

*Source: 2012 LISC study*
ERIC J. DURAN is a Managing Director of D.A. Davidson in the Public Finance Division of Investment Banking. Mr. Duran provides financial advisory services and bond financing to clients in local government, charter schools, non-profits and affordable housing (private and non-profit developers). Mr. Duran has worked in the public finance business for over thirteen years. In 2002, Mr. Duran served as the State of Colorado’s Financial Advisor on two note offerings that totaled a billion dollars, the largest note offering in Colorado’s history. In addition to providing advisory services to the State, Mr. Duran has executed 58 transactions totaling $873 million for charter schools across the country.

Mr. Duran earned his Bachelor of Arts at Colorado College and a M.P.A. from the University of Pittsburgh. He is a Woodrow Wilson fellow and a former Presidential Management Intern. Mr. Duran has served on the Denver Public Library Commission, the Board of Denver Health & Hospitals Authority and acted as the Treasurer of the Colorado Municipal Bond Dealers Association. Mr. Duran is serving on the city’s Structural Finance Committee and the search committee for a replacement for Dr. Patricia Gabow, CEO and Medical Director of Denver Health. Mr. Duran grew up in the City of Denver and graduated from North High School.
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MATT DEANGELIS is a Senior Vice President of D.A. Davidson in the Public Finance Division of Investment Banking. Mr. DeAngelis has been in investment banking since 2007. Matt is focused on the debt financing needs of educational and nonprofit institutions across the country including charter schools, independent schools, higher education institutions, museums and other nonprofits. Mr. DeAngelis serves clients in a myriad of roles and is responsible for sourcing and executing debt financings for clients. He also provides advisory services to clients related to plans for capital projects, debt capacity, credit analysis, rating agency interfacing, long-term financial analysis and financial sustainability analysis amongst other services. Matt has served a wide array of clients from small start-up charter schools to large flagship public universities.

Matt frequently publishes articles related to debt financing for education and nonprofit institutions and is a regular presenter at industry conferences and meetings including the Colorado League of Charter Schools, National Business Officers Association (independent schools) and other state independent school associations (CAL-ISBOA).

Mr. DeAngelis holds a BS in Finance from the University of Colorado. Mr. DeAngelis is a member of the Board of Trustees at the New America Charter School where he serves as Board Treasurer for both the Colorado and National networks. Matt is also a member of the School’s National Network which is charged with overseeing the growth of the School throughout the southwestern United States.
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