Form NRSRO

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APPLICATION FOR REGISTRATION AS A NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO)

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SEC 1541 (4-09)

APPLICATION FOR REGISTRATION AS A NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO)

☐ INITIAL APPLICATION

☐ APPLICATION TO ADD CLASS OF CREDIT RATINGS

☐ APPLICATION SUPPLEMENT
Items and/or Exhibits Supplemented:

☐ ANNUAL CERTIFICATION

■ UPDATE OF REGISTRATION
Items and/or Exhibits Amended:
Addition of Attachment 6 to Exhibit 2

☐ WITHDRAWAL FROM REGISTRATION

Important: Refer to Form NRSRO Instructions for General Instructions, Item-by-Item Instructions, an Explanation of Terms, and the Disclosure Reporting Page (NRSRO). "You" and "your" mean the person furnishing this Form NRSRO to the Commission. "Applicant" and "NRSRO" mean the person furnishing this Form NRSRO to the Commission and any credit rating affiliate identified in Item 3.

1. A. Your full name:

HR Ratings de Mexico, S.A. de C.V.

B. (i) Name under which your credit rating business is primarily conducted, if different from Item 1A:

HR Ratings

(ii) Any other name under which your credit rating business is conducted and where it is used (other than the name of a credit rating affiliate identified in Item 3):

N/A

C. Address of your principal office (do not use a P.O. Box):

Paseo de los Tamarindos 400-A, Piso 26, Col. Bosques de las Lomas, 05120 Mexico D.F.

(Number and Street) (City) (State/Country) (Zip/Postal Code)

D. Mailing address, if different:

N/A

(Number and Street) (City) (State/Country) (Zip/Postal Code)

E. Contact person (See Instructions):

Felix Boni, Chief Credit Officer

(Number and Street)

Paseo de los Tamarindos 400-A, Piso 26	Col. Bosques de las Lomas	Mexico, D.F.	05120
(Number and Street)	(City)	(State/Country)	(Zip/Postal Code)

CERTIFICATION:

The undersigned has executed this Form NRSRO on behalf of, and on the authority of, the Applicant/NRSRO. The undersigned, on behalf of the Applicant/NRSRO, represents that the information and statements contained in this Form, including Exhibits and attachments, all of which are part of this Form, are accurate in all significant respects. If this is an ANNUAL CERTIFICATION, the undersigned, on behalf of the NRSRO, represents that the NRSRO's application on Form NRSRO, as amended, is accurate in all significant respects.

Apr 11, 2014.
(Date)

HR Ratings
(Name of the Applicant/NRSRO)

By: ______________
(Signature)

Alberto I. Ramos, President & Chief Executive Officer
(Print Name and Title)

2. A. Your legal status:

■ Corporation ☐ Limited Liability Company ☐ Partnership ☐ Other (specify) ________

B. Month and day of your fiscal year end: December 31

C. Place and date of your formation (i.e., state or country where you were incorporated, where your partnership agreement was filed, or where you otherwise were formed):

State/Country of formation: Mexico Date of formation: June 22, 2007

3. Your credit rating affiliates (See Instructions):

N/A

(Name) (Address)

(Name) (Address)

(Name) (Address)

(Name) (Address)

(Name) (Address)

4. The designated compliance officer of the Applicant/NRSRO (See Instructions):

Claudia Ramirez Mingramm, Head Compliance Officer

(Name and Title)

Paseo de los Tamarindos 400-A, Piso 26, Col. Bosques de las Lomas, 05120 Mexico D.F.

(Number and Street) (City) (State/Country) (Postal Code)

5. Describe in detail how this Form NRSRO and Exhibits 1 through 9 to this Form NRSRO will be made publicly available on Web site of the Applicant/NRSRO, or through another comparable, readily accessible means (See Instructions):

Form NRSRO and Exhibits 1 through 9 are publicly available at www.hrratings.com/en/formnrsro

6. COMPLETE ITEM 6 ONLY IF THIS IS AN INITIAL APPLICATION, APPLICATION SUPPLEMENT, OR APPLICATION TO ADD A CLASS OF CREDIT RATINGS.

A. Indicate below the classes of credit ratings for which the Applicant/NRSRO is applying to be registered. For each class, indicate the approximate number of credit ratings the Applicant/NRSRO presently has outstanding in that class as of the date of this application and the approximate date the Applicant/NRSRO began issuing credit ratings as a "credit rating agency" in that class on a continuous basis through the present (See Instructions):

Class of credit ratings	Applying for registration	Approximate number currently outstanding	Approximate date issuance commenced
financial institutions as that term is defined in section 3(a)(46) of the Exchange Act (15 U.S.C. 78c(a)(46)), brokers as that term is defined in section 3(a)(4) of the Exchange Act (15 U.S.C. 78c(a)(4)), and dealers as that term is defined in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5))	☐		
insurance companies as that term is defined in section 3(a)(19) of the Exchange Act (15 U.S.C. 78c(a)(19))	☐		

corporate issuers	☐		
<u>issuers of asset-backed securities</u> as that term is defined in 17 CFR 229.1101(c)	☐		
<u>issuers of government securities</u> as that term is defined in section 3(a)(42) of the Exchange Act (15 U.S.C. 78c(a)(42)), <u>municipal securities</u> as that term is defined in section 3(a)(29) of the Exchange Act (15 U.S.C. 78c(a)(29)), and <u>foreign government securities</u>	☐		

B. Briefly describe how the Applicant/NRSRO makes the credit ratings in the classes indicated in Item 6A readily accessible for free or for a reasonable fee (See Instructions):

____

____

____

C. Check the applicable box and attach certifications from qualified institutional buyers, if required (See Instructions):

☐ The Applicant/NRSRO is attaching ________ certifications from qualified institutional buyers to this application. Each is marked "Certification from Qualified Institutional Buyer."

☐ The Applicant/NRSRO is exempt from the requirement to submit certifications from qualified institutional buyers pursuant to section 15E(a)(1)(D) of the Exchange Act.

Note: You are not required to make a Certification from a Qualified Institutional Buyer submitted with this Form NRSRO publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep these certifications confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the certifications confidential upon request to the extent permitted by law.

7. <u>DO NOT COMPLETE ITEM 7 IF THIS IS AN INITIAL APPLICATION</u>.

A. Indicate below the classes of credit ratings for which the NRSRO is currently registered. For each class, indicate the approximate number of credit ratings the NRSRO had outstanding in that class as of the most recent calendar year end and the approximate date the NRSRO began issuing credit ratings as a "credit rating agency" in that class on a continuous basis through the present (See Instructions):

Class of credit rating	Currently registered	Approximate number outstanding as of the most recent calendar year end	Approximate date issuance commenced
<u>financial institutions</u> as that term is defined in section 3(a)(46) of the Exchange Act (15 U.S.C. 78c(a)(46)), <u>brokers</u> as that term is defined in section 3(a)(4) of the Exchange Act (15 U.S.C. 78c(a)(4)), and <u>dealers</u> as that term is defined in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5))	☐		
<u>insurance companies</u> as that term is defined in section 3(a)(19) of the Exchange Act (15 U.S.C. 78c(a)(19))	☐		
corporate issuers	☐		

<u>issuers of asset-backed securities</u> as that term is defined in 17 CFR 229.1101(c)	☐		
<u>issuers of government securities</u> as that term is defined in section 3(a)(42) of the Act (15 U.S.C. 78c(a)(42)), <u>municipal securities</u> as that term is defined in section 3(a)(29) of the Exchange Act (15 U.S.C. 78c(a)(29)), and <u>foreign government securities</u>	☑	189	2008

B. Briefly describe how the NRSRO makes the credit ratings in the classes indicated in Item 7A readily accessible for free or for a reasonable fee (See Instructions):

Credit ratings in Item 7A are made available by press release and electronic notification to subscribe and are accesible for free at HR Ratings' website: www.hrratings.com

8. Answer each question. Provide information that relates to a "Yes" answer on a Disclosure Reporting Page (NRSRO) and submit the Disclosure Reporting Page with this Form NRSRO (See Instructions). You are not required to make any disclosure reporting pages submitted with this Form publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep any disclosure reporting pages confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the disclosure reporting pages confidential upon request to the extent permitted by law.		
	YES	**NO**
A. Has the Applicant/NRSRO or any person within the Applicant/NRSRO committed or omitted any act, or been subject to an order or finding, enumerated in subparagraphs (A), (D), (E), (G), or (H) of section 15(b)(4) of the Securities Exchange Act of 1934, been convicted of any offense specified in section 15(b)(4)(B) of the Securities Exchange Act of 1934, or been enjoined from any action, conduct, or practice specified in section 15(b)(4)(C) of the Securities Exchange Act of 1934 in the ten years preceding the date of the initial application of the Applicant/NRSRO for registration as an NRSRO or at any time thereafter?	☐	☑
B. Has the Applicant/NRSRO or any person within the Applicant/NRSRO been convicted of any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4) of the Securities Exchange Act of 1934, or been convicted of a substantially equivalent crime by a foreign court of competent jurisdiction in the ten years preceding the date of the initial application of the Applicant/NRSRO for registration as an NRSRO or at any time thereafter?	☐	☑
C. Is any person within the Applicant/NRSRO subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO?	☐	☑

9. Exhibits (See Instructions).

Exhibit 1. Credit ratings performance measurement statistics.

☐ Exhibit 1 is attached and made a part of this Form NRSRO.

Exhibit 2. A description of the procedures and methodologies used in determining credit ratings.

■ Exhibit 2 is attached and made a part of Form NRSRO.

Exhibit 3. Policies or procedures adopted and implemented to prevent the misuse of material, nonpublic information.

☐ Exhibit 3 is attached and made a part of this Form NRSRO.

Exhibit 4. Organizational structure.

☐ Exhibit 4 is attached to and made a part of this Form NRSRO.

Exhibit 5. The code of ethics or a statement of the reasons why a code of ethics is not in effect.

☐ Exhibit 5 is attached to and made a part of this Form NRSRO.

Exhibit 6. Identification of conflicts of interests relating to the issuance of credit ratings.

☐ Exhibit 6 is attached to and made a part of this Form NRSRO.

Exhibit 7. Policies and procedures to address and manage conflicts of interest.

☐ Exhibit 7 is attached to and made a part of this Form NRSRO.

Exhibit 8. Certain information regarding the credit rating agency's credit analysts and credit analyst supervisors.

☐ Exhibit 8 is attached to and made a part of this Form NRSRO.

Exhibit 9. Certain information regarding the credit rating agency's designated compliance officer.

☐ Exhibit 9 is attached to and made a part of this Form NRSRO.

Exhibit 10. A list of the largest users of credit rating services by the amount of net revenue earned from the user during the fiscal year ending immediately before the date of the initial application.

☐ Exhibit 10 is attached to and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 11. Audited financial statements for each of the three fiscal or calendar years ending immediately before the date of the initial application.

☐ Exhibit 11 is attached to and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 12. Information regarding revenues for the fiscal or calendar year ending immediately before the date of the initial application.

☐ Exhibit 12 is attached to and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Exhibit 13. The total and median annual compensation of credit analysts.

☐ Exhibit 13 is attached and made a part of this Form NRSRO.

Note: You are not required to make this Exhibit publicly available on your Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). You may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment. The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

Charter Schools Credit Risk Evaluation

April 7, 2014

Methodology

Contacts

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Charter School Debt Methodology

In this document HR Ratings details our methodology for the evaluation of the credit quality of U.S. charter schools. Our methodology relies primarily on the issuer's historic, current and projected financial statements and enrollment, as the latter is the primary revenue generator. Also of crucial importance is the level of risk arising from the possibility of losing the charter and more generally the political risk inherent in this asset class.

HR Ratings' credit risk analysis reflects our view of the issuer's ability and willingness to make interest and principal payments promptly and in full. Our ratings do not reflect expected recoveries in the event of default, nor do they incorporate views about non-credit factors that may impact the trading price of the issuer's bonds such as their liquidity.

As charter school issued debt typically is general obligation in nature our rating methodology makes use of our corporate methodology with adjustments as required by the peculiarities associated with this asset class as discussed in this document. In those cases in which the servicing of charter school debt is linked to a specific revenue source that also has preference to its use for the servicing of general obligation debt, our future flows methodology will be applied to the evaluation of its level of credit risk.

Although Charter School debt is rated using our corporate or future flows methodology, we regard it as a subset of our public finance asset class. This is due to the fact that the source of payment is ultimately derived from tax revenues, which is a distinguishing characteristic of the public finance asset class.

Basic Concepts and Definitions

In this document HR Ratings discusses the adjustment of our general corporate rating methodology to the peculiarities of U.S. charter school debt. Our methodology relies primarily on the evaluation of the issuer's historic, current and projected financial statements including its enrollment, which generally is the primary revenue driver. Extremely important is our evaluation of the risks associated with the retention of the charter for as long as there exists outstanding debt.

HR Ratings' credit risk analysis reflects our view of the issuer's ability and willingness to make interest and principal payments promptly and in full. Our ratings do not reflect expected recoveries in the event of default, nor do they incorporate views about non-credit factors that may impact the trading price of the issuer's bonds such as their liquidity.

As charter school issued debt typically is general obligation in nature our rating methodology makes use of our corporate methodology, with adjustments as required by the peculiarities associated with this asset class as discussed in this document. Our corporate methodology focuses on the forecasting of cash flows under base and stress case scenarios and the resulting ability to meet debt servicing obligations, largely as reflected in key metrics such as debt service coverage ratios and years of debt relative to free cash flow. In those cases in which the servicing of charter school debt is linked to a specific revenue source that also has preference to its use for the servicing of general obligation debt, our future flows methodology will be applied to the evaluation of its level of credit risk. This generally involves the degree of stress that an entity can support relative to a base case scenario and at the same time continue as a going concern.

We expect that "structured" debt linked to a specific revenue source with preference over the servicing of general obligation debt will generally have lower credit risk than the school's general obligation debt. For both general obligation and structured debt a key variable will be the Debt Service Coverage Ratio (DSCR) ratio and the length of time expected to be required to liquidate the debt. In this context free cash flow is a major variable although EBITDA is also utilized.

In our analysis of general obligation corporate debt we need to be able to assume that the entity is a "going concern", as reflected in its financial viability. In the case of a charter school we look to the possibility of making a similar conclusion. However, we also have to examine the nature of the school's regulatory regime to evaluate possible risks such as the maintenance of required academic performance levels, to its ability to operate and thus service its debt.

The first section of this document offers a general description of charter schools, their basic characteristics and the credit risks this type of institution commonly faces. The following section will briefly mention how HR Ratings will determine the Quantitative Rating by applying the Corporate Methodology, or the Future Flows methodology for very specific cases.

Lastly, in the final section, we will discuss the different qualitative aspects that the methodology considers noting the manner in which way these will affect the quantitative rating granted.

General Description

According to the National Alliance for Public Charter Schools (NAPCS), over 2.5 million students are enrolled in almost 6,440 charter schools around the United States for the 2013-14-school cycle. This stands in contrast to the 2000-01 cycle, in which charter schools accounted for only 459 thousand students, less than 20% of the current head count.

Charter schools, regarded as public schools, are allowed to implement their own policies, methods and curriculum, hence offering alternatives to traditional public schools, facilitating experimentation and permitting greater parental involvement and choice. As a result, charters have been successful in attracting students as their growth in enrollments suggests.

Although having greater flexibility and independence, charter schools are public in nature as they receive between 70% and 90% of their funding from state transfers. Most characteristically, these schools operate under contract with the state and thus need to meet these contractual obligations within a predetermined time frame, risking charter revocation for not fulfilling them.

Charters are considered by their defenders to be among the top-performing schools in the United States, at least when controlled for the socioeconomic background of their student bodies. Arguably they can also generally be set up more quickly than a new traditional public school, depending on each state's own regulation. They are open to all students, do not charge tuition, and generally do not have any special entrance requirements.

By the 2012-13 academic year, only eight states in the U.S. were without a charter law. In states such as Arizona, California, Colorado, Florida, Louisiana, Michigan, New York, Ohio and Texas charter schools have thrived for the past decade. Their success comes despite the challenges posed by legislative oversight and funding limitations. States provide a predetermined fee to each charter school for every student enrolled. Additionally, charters can obtain revenue from donations or certain extracurricular activities, but these will usually represent a small amount compared to state transfers.

Charter schools face tough competition, not just from traditional public schools (which may be better funded), but also from private schools and other charters. Because most of their funding depends on the number of students enrolled, generating demand is essential for financial viability. Usually, academic performance drives demand, so the charters with longer waiting lists are often those that are more likely to perform well vs. local public schools.

Academic performance not only drives demand, it is also the main factor resulting in charter revocation. Given their experimental nature one would expect that charter schools will continue to emphasize curricular innovation and meeting individual student needs. As the number of charter schools increase we expect that competition for students will probably intensify. According to the NAPCS, during the 2012-13 academic years, 206 charter schools closed, by the next year, 642 opened, a 3 to 1 ratio. New charters tend to replicate existing and proven models, further intensifying competition.

Additional challenges for underperforming charter schools come with new academic performance standards imposed by each state, as well as caps on enrollment levels. This challenge has to be understood within the context that charters receive significantly less funding per student than traditional public schools. This usually means that charter cannot offer certain services to students that traditional schools can, such as transportation or better facilities. Of course there is the possibility that students who do not migrate to charters might present more challenges to teachers thus requiring more generous funding. Further risks include aggressive expansion plans that can compromise their financial stability and socioeconomic stress or weak demographic trends that could harm enrollment levels, increasing competition among the schools in the area.

As demand for charters schools grow, so too the need to accommodate more students. Management teams and boards of directors are becoming more sophisticated in order to adapt not only to state legislation but also to students' demand. As revenue sources remain limited, charter schools have turned to the debt market in order to improve their services by providing better facilities to properly serve such increasing demand.

Independently of the isolation of the revenue source, charter schools' credit quality is threatened by other factors, mainly: state funding cuts or delays and constant fluctuations on enrollment levels, which remain as the main source of income. Limited expertise from the management team will be reflected in the financial statements, severely hindering the issuer's financial flexibility. The accumulation of cash is particularly relevant as it serves as protection from any unexpected event. In contrast, ambitious and rapid expansion of capacity financed through debt may create financial vulnerabilities in the future under stress scenarios. For its part, academic performance not only has an important role in determining demand but it also serves as the entity's best defense against charter revocation, as most states condition charters to the attainment of a required academic level and to an acceptable financial performance.

Despite state approval, municipalities may oppose charter schools. Thus political risk has to consider opposition at state, municipal and community levels. Usually, states have the authority to grant or revoke charters, but in some states the municipalities hold these capacities.

Quantitative Analysis

While developing the quantitative model HR Ratings will first have to address a very specific legal issue; is the revenue source completely isolated from the entity? In this particular case, HR Ratings will apply its Future Flows methodology considering the terms of the trust that isolates de revenue source.

In the case in which the revenue source is not isolated, HR Ratings will apply its Corporate Methodology, which includes specific profitability ratios and determines if the future cash flow generation will be able to cover at least operating expenses and debt service.

In all cases, HR Ratings credit evaluation process involves making detailed financial forecasts under both base and stress case scenarios.

Our forecasts and the metrics that they produce will form the basis for the determination of a Quantitative Rating. The process then evaluates relevant qualitative factors that may alter this rating on a multi-notch basis in either direction.

Qualitative Analysis

Charter schools face risks that cannot be properly incorporated within the quantitative model. Some factors are not under the direct control of the entity and will not be reflected in the financial statements. For example changes in the regulatory environment (positive or negative), changes in the level of funding beyond the risk parameters incorporated in the stress scenario, changes in student characteristics that make it more difficult or less to maintain past academic levels. These risks include the revocation of the charter. These factors may alter the Quantitative Rating by more than one notch in either direction, and will only be incorporated if the Analysis Committee determines to do so.

This section emphasizes these factors by dividing them into three categories. We list them below:

- Management and Future Debt Issuance
- Demand Factors
- State Regulation and Legislation

We will later show how these considerations may determine the Final Rating.

Management and Future Debt Issuance

Charter schools usually begin with a project established by a few founders, but as success comes in and student head count increases, more sophisticated management is required. HR Ratings will determine the strength and diversity of the management team and the board of directors by analyzing each member experience and field of expertise.

A higher rating typically implies that the division of labor within the management team is clearly defined. We would expect to see members specialize in specific areas such as administrative, fiscal and academic. Some charters may choose to contract an external financial management organization to perform that function. In these cases we will determine the experience of the organizations and whether the said contract provides a cost-effective alternative. If a school outsources other specialized services, we will apply the same procedures as defined here for financial management.

With the increase in student enrollment, charter schools face the need for better and larger facilities. New debt issuance is the only available way for some schools to finance the investment needed for such infrastructure projects, thus increasing potential risk. Capable management is necessary, as the investment via debt will now require not only debt servicing costs but also higher maintenance expenses. Larger student enrollment is also necessary to defray the higher costs with the attendant risk that quality may decline thus risking charter revocation.

Expansion may also require the addition of new grade levels increasing the complexity of the services provided. New teachers need to be contracted and facilities accommodated for more students, while sustaining the academic level. For this reason HR Ratings will also evaluate the experience of the teaching staff as well as past accomplishments.

Demand Factors

Demographic Trends and Competition

Student demand, and ultimately enrollment, is a key element in the evaluation of a charter's credit quality. Most of the charter school's funding depends on the student headcount as state transfers are calculated in a per student basis. HR Ratings will closely analyze the demographic profile in the charter school's market to determine if there is a demand for the service provided. For this reason it is very important to determine the service area (or the total available school age population) to which the school philosophy is suited. The area determination will also consider the transportation services around the facilities. A better-connected school will usually have a greater student pool. Of course, economies of scale factors will be incorporated into the analysis as some smaller schools may easily operate with fewer students, while larger schools might require a greater enrollment to cover their fix costs.

As for demographic factors, HR Ratings will study historic, and further project, population dynamics such as: the age distribution, growth trends or housing and services projects, and migration trends.

These factors will be reflected in each school's enrollment trends. A stable or growing trend, with good retention rates, will typically imply a suitable population dynamic for the targeted area. We expect the charter school to have historic data for every year since operations began, as well as a reasonable projection for future enrollment that permits meeting its debt service obligations. HR ratings will not necessarily utilize these projections in the development of its base case scenario but will take them into consideration as an additional analytical tool. HR Ratings will also want to see a full history of the charter's academic performance measurements.

Another major factor besides the population dynamic is the already existing competition in the targeted area. Public schools, private schools and other charters schools will consume student demand; hence, HR Ratings will want to analyze enrollment trends for these institutions to better determine the threat that these represent to each other. We will also want to see academic performance measures for competing charters. The best way by which HR Ratings could evaluate the relative performance of the charter school being rated is by revising the historic enrollment data (described above) and a well-documented and continuously updated waiting list. The second variable is the best proxy for comparative performance and will also indicate the capacity for a school to embark on future facility expansion programs that require new debt issuance and greater state funding. This will be necessary if the area around the charter schools quickly develops attracting more population and student demand.

In order to understand the competitive environment within which charters operate, HR Ratings will also take into consideration the financing mechanisms for traditional public schools. Although generally charter schools might receive less per student enrolled than the overall statewide public school system there might be variations across local school districts. This could impact the relative competitiveness of individual charter schools.

Regarding funding, charter schools may have very specific advantages over traditional public schools and private schools. For example, if public schools depend upon the local municipal tax base and if that tax base deteriorates, in contrast to what might occur at the state level, the charter school might find itself in an improving situation vs. its traditional public school competition. Of course, the opposite dynamic could also come in to play.

Academic Performance and other Services

Charter schools often score better than comparable conventional public schools in standardized tests and may even be competitive vs. private schools, especially on a cost-benefit basis. So consequently, they present themself in the community as an educational alternative to local public and private schools. Academic performance is the strongest factor that determines demand and will distinguish one charter form another. As we mentioned before, a strong and consistent waiting list will typically indicate that a charter school outperforms its immediate competition.

Both students and parents hold different consumption preferences, so academic performance will not be the only variable to consider while enrolling in a different school. Older students tend to prefer schools that have bigger facilities that are fitted for different activities such as arts and sports. Parents with younger children will search for schools that have their own transportation services and that offer activities after hours or day care services. The ability to provide extracurricular activities that will complement student's abilities and curriculum can be a decisive factor to distinguish students in the process of applying for collage education.

Academic performance is an important factor that can affect the license renewal. Better facilities will increase maintenance cost (with greater fixed and variable costs) and other services will drive operating costs. A charter school needs to understand its limitations considering its demand and should adapt by finding and optimal operating strategy.

State Regulation and Legislation

State Support

Each state in which charter schools are allowed to operate has developed its own legislation regarding the subject. As a result, each regulatory framework can be substantially different. HR Ratings accounts for these factors but still considers that certain common characteristics can benefit or greatly increase the credit risk of charter school operation.

In some states funding levels have fallen over the last few years, forcing charters to better manage their costs and forcing them to apply for an expansion in their enrollment limits. Other states can even subordinate payments to charters schools to other obligations, resulting in possible delays.

Some states have successfully implemented programs to aid charter school with their debt obligations, such as Texas that now allows charter schools to apply for the Permanent School Fund.

Beside states, we will also review the local legislation and the community acceptance, as these factors could affect charter revocation or diminish demand for the institution.

State Oversight

The legislative framework varies between states, but we will expect to see perfectly defined criteria regardless of particularities. With well defined reporting requirements and academic expectations HR Ratings can better determine the school's performance and will face less uncertainty while evaluating the probability of sustaining the charter or the financial support.

For a better rating we would expect the oversight role of the state to be clearly defined; one in which the state will continuously review, and if necessary, intervene in times of administrative and financial distress. We will also expect to find in detail a set of academic standards with which each charter should comply and a well-defined minimum financial performance to continue operating or even access the private investment market.

Charter Renewal

For most states, charter periods last between three to five years, while charter school debt issues may be for longer periods. For HR Ratings to accurately determine the charter renewal risk we will study each state's legislation in order to evaluate the clarity of the relevant criteria and the risks involved for the retention of certification.

As part of the renewal process, we will examine possible appeal procedures and the possibility to transfer the charter to different sponsors or ownership groups.

Final Rating

The Initial Rating, determined in the quantitative model, can be altered by each of the qualitative factors described above through multi-notch adjustments.