

Paying for the Charter Schoolhouse:

A Policy Agenda for Charter School Facilities Financing

Executive Summary

Locating and financing facilities has been the most daunting challenge facing many charter schools. This report from the Charter Friends National Network outlines five strategies state policy-makers can pursue to ensure that charter schools can gain access to suitable, high-quality facilities.

The report describes four dimensions of the charter school facilities finance challenge:

- ◆ *The supply challenge:* in many places, very few suitable facilities are available.
- ◆ *The revenue challenge:* while district schools generally have special funding streams for capital, most charter schools must pay for facilities out of their regular operating funds.
- ◆ *The tax status challenge:* charter schools are often unable to take advantage of the low-cost financing available to district schools in the form of tax-exempt debt.
- ◆ *The risk challenge:* lenders, investors, and property owners often regard charter schools as high-risk, charging them a premium or refusing to do business altogether.

In response to these challenges, policy-makers across the country have begun to enact strategies to alleviate charter schools' facilities problems. This report reviews five of those strategies, providing examples of existing efforts to implement them:

- ◆ *Strategy One: Provide adequate revenue to cover facilities costs.* Several states now offer charter schools per-pupil revenues *beyond their operating funds* to pay for capital expenses. One state, Florida, also provides one-time up-front payments to help schools pay for buildings.
- ◆ *Strategy Two: Give charter schools access to low-cost financing.* Two states have empowered existing bond authorities to issue tax-exempt bonds for charter schools. Another option is to ensure that charter schools can issue tax-exempt debt directly.
- ◆ *Strategy Three: Create or stimulate finance pools for charter schools.* Chicago Public Schools and several private entities have established dedicated loan pools for charter schools.
- ◆ *Strategy Four: Provide incentives for organizations to supply facilities.* Policy-makers can encourage local school districts, other governmental entities, property owners, employers, and real-estate developers to provide facilities for charter schools.
- ◆ *Strategy Five: Consider other ways to improve the facilities climate.* Addressing investors' concerns about the short terms of charters, ensuring charter schools are exempt from property taxes, making it clear that charter schools can own facilities, and making it possible to convert existing schools to charter status would all help improve the facilities climate for charter schools.

Addressing the Charter School Facilities Finance Challenge

For many of the 1,100 charter schools now operating around the country, locating and financing facilities has been the most daunting challenge. In one Midwestern state, four of the ten charter schools that had been approved could not open in the fall of 1997 because they were unable to find suitable and affordable facilities. Earlier in 1997, a chartering authority in another state rescinded more than a dozen charters from schools that never opened, in many cases because the schools' organizers could not find or afford space. Even for many schools that manage to find space, problems remain: facilities are too small to accommodate enrollment; facilities are not well matched to the school's academic program; or the cost of facilities eats into funds intended to pay for instruction. As a result, in the U.S. Department of Education's nationwide survey of charter schools, "inadequate facilities" ranked third on a long list of barriers cited by charter operators. The closely related items "lack of start-up funds" and "inadequate operating funds" ranked first and second.

Charter schools have approached this challenge with great creativity. They have converted many kinds of buildings into functional, attractive schoolhouses. They have found ways to carry out some school activities — like athletics — in nearby facilities rather than trying to do everything on campus. They have persuaded property owners to donate space or offer it at a reduced rate. They have tapped into existing sources of financing for community development. And they have found a range of sources of private funding for school construction and renovation. As in many other domains, charter schools have emerged as pioneers in the area of school facilities.

But as creative as charter schools have been, the charter school facilities challenge demands a response from policy makers, for several reasons:

- ◆ **Giving charter schools a chance to have an impact:** To give the charter school idea a full test, policy-makers must make it possible for a large number of charter schools to emerge and prosper. But the facilities challenge threatens to place artificial limits on the supply of new charter schools. For policy-makers serious about expanding the number of quality charter schools, addressing facilities issues should be a top priority.
- ◆ **Focusing operating resources on quality instruction:** In traditional public school finance, capital costs are paid for with revenue streams that are separate from operating revenues, freeing up schools to spend all of their operating dollars on their educational programs. As part of creating a "level playing field" for charter schools, policy-makers should ensure that charter schools have the same opportunity to focus resources on academic pursuits.
- ◆ **Ensuring equal access to the charter school opportunity:** Part of the appeal of the charter idea is that any group of citizens — including parents and teachers — can propose a charter school. But some groups — such as parents in low-income neighborhoods — have more difficulty than others obtaining financing for school facilities because they

lack the financial resources needed to guarantee financing or access to technical expertise. If policy-makers want citizens from all walks of life to have the chance to launch charter schools, it is vital to ensure that “deep pockets” are not a prerequisite.

- ◆ **Informing broader policy debates about school funding:** Across the nation, debates rage about how to provide funding for public education in an equitable fashion. Many people (and courts) believe that the traditional system — in which schools’ capital resources depend largely on local wealth — is unfair, and states are groping for solutions. Since charter schools have no tax base, they represent a critical testing ground for policies designed to disengage school capital funding from local wealth. Ideas pioneered in the charter school arena could well inform the restructuring of school funding systems more broadly.

This policy report from the Charter Friends National Network, the result of over a year of research on promising strategies underway around the country, aims to sketch out a policy agenda to address the charter school facilities finance challenge. Since states’ charter school laws and school funding systems are so different, the document does not offer model legislation. Instead, it lays out five strategies that policy-makers might consider when thinking about the charter facilities problem, providing examples of states that are putting the strategies into practice and probing some of the issues policy-makers need to consider as they move forward.

The report has three main parts: “*Dimensions of the Facilities Financing Challenge*” gives more detail about the difficulties facing charter schools in obtaining adequate and affordable facilities. “*Five Promising Strategies for State Policy*” sets out some principles to guide charter facilities policy-making and provides details about the five recommended strategies for state policy-makers. And “*Beyond State Policy*” looks briefly at some actions groups other than state policy-makers — Congress, local officials, charter friends groups, and charter schools themselves — can take to ease the charter facilities challenge.

Dimensions of the Facilities Financing Challenge

Why have charter schools faced such difficulties in locating and financing facilities? Understanding the roots of the problem is essential to crafting policy responses. This report identifies four key dimensions to the charter school facilities challenge: the *supply* of adequate facilities, the lack of *revenue* for charter school facilities, the sometimes ambiguous *tax status* of charter school finance and facilities, and the *risk* private lenders and investors face in the charter school market.

Before addressing each dimension, a word about terminology is in order. When charter schools seek financing for facilities, they may do so in a number of ways. They may approach a lender for a loan, approach investors to purchase bonds or otherwise make an investment, or approach a property owner for a long-term lease. Though these are different forms of financing, they present more or less the same issues for charter schools. To simplify the presentation, this document generally uses the term “investors” to refer to those who might provide charter schools

with the means to obtain a facility — whether those investors are lenders, property owners, potential holders of bonds, or other providers.

The Supply Challenge

One of the first problems many charter schools face is simply the relative scarcity of appropriate facilities for schools in their communities. Schools require a fairly large amount of space and space that is configured (or can be) for educational uses. Often, there are few properties available in a town that fit the bill. And those that are available may well be too expensive for charter schools to consider, or require renovation that would be too costly to undertake. These problems are especially severe in rural areas and in locations with tight property markets.

The Revenue Challenge

Though the number of exceptions is growing (see below), state charter school laws typically do not provide charter schools with any up-front funding for facilities, nor do they provide charter schools with ongoing revenue with which to make lease or loan payments. As a result, charter schools must raise private funds or find other financing for up-front costs and then make lease and loan payments out of their operating funds. Since it is not uncommon for facilities costs to amount to 20-25% of a charter school's costs, the effect on a charter school's operating budget can be severe.

The Tax Status Challenge

School districts typically raise capital funding by issuing tax-exempt bonds, or by having other local government bodies do so on their behalf. Since investors in tax-exempt bonds do not pay taxes on the interest they earn, these bonds carry a lower interest rate than fully taxable bonds would. In addition, school districts typically do not pay property taxes on the land and buildings they own. These two tax advantages lower the overall costs of school facilities significantly. Though charter schools are public schools, it is often ambiguous whether they enjoy these same tax advantages. In particular, it is sometimes unclear:

- ◆ whether charter schools themselves may issue tax-exempt debt;
- ◆ whether other public bodies (such as city and county governments or special-purpose finance authorities) may issue tax-exempt bonds on behalf of charter schools;
- ◆ whether charter school facilities are exempt from property taxes.

In other cases, state law explicitly denies such advantages to charter schools. For example, North Carolina law prohibits county governments, the state's chief providers of school facilities funding, from offering capital funds to charter schools. Consequently, charter schools end up paying more (all else being equal) for facilities than they would if they were part of conventional school districts.

The Risk Challenge

The final, but perhaps most significant, dimension of the charter facilities challenge is the risk faced by investors in charter school facilities, be they lenders, property owners, bond investors, or others. In conventional school bond issues, potential bondholders generally regard these bonds as very low-risk investments. Typically, the bonds are backed by the “full faith and credit” of the issuing authority, which means that the issuer promises to tax its citizens as much as it needs to in order to repay the bonds. And in any case, there is little chance that a school district (or other government issuer) will go out of business. Since district school bonds are such a low-risk proposition, investors are willing to accept relatively low interest rates.

Charter schools do not enjoy the same reception in the capital markets. To begin with, charter schools do not have the authority to tax citizens, so they cannot pledge future tax payments as backing for financing. In addition, potential investors may regard charter schools as high-risk for a variety of reasons:

- ◆ **Start-up / management risk:** Any enterprise without a proven track record — charter school or not — is likely to look risky to a potential investor. High turnover rates and the overall newness of the charter field may heighten such fears in the charter school case. In truth, very few charter schools have failed (see box). But investors are still likely to charge a premium to charter schools, especially those starting from scratch.

National Study Shows Charter School Success Rate Very High

The US Department of Education’s nationwide charter school study reports that of the 712 charter schools that opened through the time of the study, only 19 had ceased operation as of September 1997. And of these 19, seven discontinued their charters but remained open, either as private schools or by merging with other charter schools. Less than 2% of charter schools closed because they lost their charters or voluntarily “went out of business.” Read the national study at the U.S. Department of Education’s website (ed.gov/pubs/charter98).

- ◆ **Renewal risk:** Charter schools receive charters with a limited duration. In most states, they must seek renewal at the end of 3-5 years. Many facilities loans and leases, by contrast, must extend for 15-30 years in order to be economically viable for the school. So investors must be willing to offer financing with a term longer than that of the charter. By itself, this situation does not introduce any special risks for investors in charter schools — a typical business borrower, of course, has no charter at all and could go out of business at any moment. But if the process by which a school’s renewal will be handled and the criteria by which it will be judged are not

clear or highly political, investors may regard the renewal process as a risk that is difficult to assess, and thus high.

- ◆ **Collateral risk:** In the event that a charter school fails, at least investors can assume control of the financed facility and try to recoup their investments. But two factors might lower the value of this collateral in the charter case. First, buildings fashioned as schools may be difficult to convert to other uses; if no other school is willing to occupy the facility, investors may suffer a loss. Second, state charter laws are sometimes unclear about what happens to a charter school's assets in the event of closure. For example, a charter law that directs school assets to revert to the local school district may decrease the value of the collateral to investors.
- ◆ **Political risk:** In addition to the school-specific risks above, investors may also worry that the state legislature might discontinue its authorization of charter schools. No state has done so to date, but the possibility exists, and investors may take it into account.

Five Promising Strategies for State Policy

This section includes a set of principles to guide charter school facilities policy-making, followed by a description of five promising strategies state policy-makers might consider to address the facilities challenge. Each of these strategies is based on actions taken by some state legislatures or local governments in the United States, though no state has yet adopted a complete charter school facilities policy. The first four strategies roughly address the four dimensions of the charter school facilities challenge described in the previous section: Strategy One addresses the revenue challenge; Strategy Two the tax-status challenge; Strategy Three the risk challenge; and Strategy Four the supply challenge. Strategy Five addresses multiple challenges.

Principles

The charter school idea is based on a set of principles about how schools should be authorized, governed, regulated, and funded. Many of these same principles can serve as guides for policy-making around charter school facilities:

- ◆ **Level playing field:** Charter schools ought to have access to the same fiscal advantages that school districts enjoy. *These advantages need not be structured identically to districts' financing systems*; alternative structures that provide equivalent advantages still create a level playing field. In the facilities context, the primary advantages typically enjoyed by districts are:

- ✓ access to low-cost capital (typically through tax-exempt bonds)
- ✓ public guarantees of districts' obligations (typically through taxing authority)
- ✓ revenue stream *above and beyond operating funds* to pay facilities costs
- ✓ exemption from property taxes

It should be noted that school districts often do not receive the first three of these advantages automatically — in many jurisdictions, districts (or others acting on their behalf) must obtain “yes” votes on public referenda or go through other processes to gain authorization for borrowing. A level playing field therefore demands that charter schools face some equivalent mechanisms, described under “accountability” principle, below.

- ◆ **Equal access:** Policy-makers should strive to make it possible for all successful charter school operators — not just those from wealthy communities or with wealthy backers — to have access to the sorts of financing discussed in this report.
- ◆ **Flexibility:** In the spirit of charter school autonomy, facilities funding should not come with regulatory “strings” beyond those required to ensure that funds are properly spent and accounted for.
- ◆ **Accountability:** The traditional mechanism of ensuring that a school districts’ facilities financing is sensible — the requirement of a public referendum on the issuance of bonds — cannot be used in the charter school case, since charter schools do not have defined political jurisdictions or electorates. Policy-makers must look for other ways to ensure that funds are used appropriately.
- ◆ **Efficiency:** In many arenas, charter schools are experimenting with ways to do things differently, and often more efficiently, than district schools. Facilities should be no exception. Policy-makers should consider including incentives for charter schools to find new ways to be economical in their facilities decisions.

Strategy One: Provide Adequate Revenue to Cover Facilities Costs

A first strategy is to ensure that charter schools receive a fair share of public funding available for school capital costs. As noted above, since most state funding formulas for charter schools only provide a share of *operating* funds, charter schools typically have to dig into operating dollars to make lease or loan payments. To address this problem, policy-makers should consider following the lead of a small number of charter states by providing revenue — above and beyond regular operating funds — for charter school facilities costs.

Five jurisdictions have begun to provide such funding — Arizona, the District of Columbia, Florida, Massachusetts, and Minnesota. (Appendix A explains the essential terms of each of their policies; Appendix B contains contact information). In crafting these funding mechanisms, policy-makers grappled with a set of issues:

- ◆ **Amount:** The amount of annual funding provided by states ranges from as much as \$1,200 per pupil for some schools in Arizona to as little as \$260 per pupil for schools in Massachusetts.
- ◆ **Basis:** The variation in amounts springs largely from different bases used by states to set charter schools' facilities revenue. There are four basic models, outlined in the box. In addition, most states (but not all) provide more money per-pupil for high schools than for elementary schools.

Different Ways to Calculate Charter School Facilities Funding

New construction costs. Florida statutes establish the projected cost of constructing a new elementary, middle and high school. Annual per-pupil facilities funding for charter schools in Florida is simply these amounts divided by 30, the estimated amortization period for school facility financing.

Districts' actual annual costs. Minnesota totals up what school districts actually spend annually on facilities costs (e.g. debt service on past bond issues), divides this number by the number of pupils, and arrives at a per-pupil expenditure by that means. This number forms the basis for a statewide maximum in "building lease aid" that a charter school can receive.

State's annual costs. In Massachusetts, the state provides millions of dollars per year for local districts' capital projects. The state divides this total by the number of public school students in the state to determine the average per-pupil state capital expense, and then provides this amount to charter schools on a per-pupil basis.

Charter schools' projected needs. In Arizona, part of the amount charter schools receive for facilities has been based on projections of how much typical charter schools will spend on facilities.

- ◆ **Source:** In most jurisdictions, per-pupil funding for charter school facilities is "new money" — not funds deducted from allocations to districts. In Arizona, the money "follows the child" from a district to a charter school.
- ◆ **Flexibility:** In all states but Florida and Minnesota, charter schools may spend this funding as they see fit, including expenditures on items other than school buildings. For example, if a school in Massachusetts obtained a donated facility, it still received \$260 per pupil in 1998-99 for facilities. In Minnesota, by contrast, schools are reimbursed for a portion of actual lease costs incurred, up to a maximum level. Florida restricts use of the money to capital outlay — though this term includes equipment as well as bricks and mortar.

- ◆ **Incentives for economy:** Each state provides some incentive for charter schools to be economical in meeting their facilities needs. In all the states but Minnesota, schools have this incentive because they may use the funds they receive for capital for any purpose (see previous bullet). As a result, any savings they realize on facilities may be used for other school needs. In Minnesota, the state reimburses only up to 80% of a school's lease cost. Requiring a 20% "co-payment" gives schools an incentive to hold costs down.
- ◆ **Annual vs. one-time:** Alone among these states, Florida also makes it possible for charter schools to receive one-time lump sum payments in lieu of annual facilities funding through the School Infrastructure Trust Fund (see box)

Florida's School Infrastructure Thrift Fund (SIT)

A district in which charter schools have been operating in non-district facilities for at least a year is eligible for payments of \$5,800 (for elementary) to \$8,800 (for high) per pupil attending the charter schools. And as the charter schools' enrollment grows, the district receives additional payments. While districts are not technically required to share this money with the charter schools that generated it, most are doing so because their application to the state for the money must be signed by the charter school(s) in question. Escambia Charter School received nearly \$1.26 million in 1998 under this program. A full listing of SIT awards is online (www.firn.edu/doe/bin00046/046_266.htm); links to the legislation are in Appendix B.

Strategy Two: Give Charter Schools Access to Low-Cost Financing

Strategy One gives charter schools a source of funds with which to repay loans or make lease payments. But it does not address the high cost charter schools are likely to pay for loans and leases due to the factors described in the "Dimensions" section, above. One way state policy-makers can bring down those costs is to ensure that charter schools have access to tax-exempt financing or some equivalent low-cost form of capital.

Tax-exempt financing

To tap into tax-exempt financing, a charter school has two main choices: (a) convincing some entity with the power to issue tax-exempt debt (like a city, a state, or another public authority) to do so on its behalf; (b) convincing a lender or other investor that since the charter school is itself a public authority, any financing provided to it is tax-exempt.

How can state policy smooth these two paths for charter schools? State laws can make it easier for charter schools to obtain this kind of financing in these ways:

- ◆ **Making clear that existing entities may issue bonds on behalf of charter schools.** All states empower a wide range of public bodies to issue bonds — cities, counties, and a host of special purpose authorities, such as those created to issue bonds for postsecondary educational institutions, cultural institutions, housing or medical facilities. But states often restrict the purposes for which these bonds may be issued. For example, some states have legislation stating that a given entity may only issue bonds for an explicit list of purposes. Because these laws were usually passed long before charter schools existed, charter school facilities may not be included in such lists of eligible purposes. One way state policy-makers can address charter schools' facilities needs, then, is to make clear in legislation that a range of entities may issue bonds on behalf of charter school projects. Such laws do not require them to do so, but they open up an avenue that charter schools can pursue (see box for two recent examples).

Colorado and North Carolina Expand Bonding Authorities to Include Charters

State legislatures in both Colorado and North Carolina have passed legislation altering the rules governing existing bonding authorities to make charter schools eligible for financing.

- ◆ **In Colorado**, the General Assembly changed the name of the Colorado Postsecondary Educational Facilities Authority to the Colorado Educational and Cultural Facilities Authority and expanded the list of eligible beneficiaries to include organizations that “provides an educational program pursuant to a charter from a school district.” Contact Mark Gallegos at the Authority (303/297-7332) or see Colorado Senate Bill 82 (1998) online (www.state.co.us/gov_dir/leg_dir/sess1998/sbills98/sb082.htm).
- ◆ **In North Carolina**, the General Assembly expanded the mandate of the NC Educational Facilities Finance Agency to include any “nonprofit institution within the State of North Carolina authorized by law and engaged or to be engaged in the providing of kindergarten, elementary, or secondary education, or any combination thereof.” Contact Bryan Hassel of the North Carolina Charter School Resource Center (704/370-0357) or see North Carolina Senate Bill 1556 (1998) online: (www.ncga.state.nc.us/html1997/bills/ratified/senate/sbil1556.full.html).

- ◆ **Making clear that charter schools are themselves public authorities and thus eligible to obtain tax-exempt debt on their own.** Since charter schools are public schools, authorized by a public body and subject to closure by that public body, many argue that charter schools are in fact public entities in their own right and thus eligible to obtain tax-exempt financing on their own. For example, a bank making a conventional loan to a charter school would not have to pay federal income taxes on the interest it earned if the charter school were in fact a public entity. The legal issues surrounding such financings, however, are complex, and state legislatures could make them easier to arrange by clarifying in statute that charter schools are public entities. The exact language required

would vary from state to state. In addition, policy-makers would want to investigate whether such a declaration would have other implications for charter schools. For example, would being a public entity create certain obligations for charter schools (regarding reporting, board membership, etc.) that policy-makers do not want to impose upon them?

- ◆ **Facilitating the arrangement of pooled financing for charter schools.** Clearing the *legal* path for the issuance of bonds on behalf of charter schools is one step toward opening up this avenue of funding. But there are also *economic* barriers to charter schools' access to tax-exempt financing; these are addressed under Strategy Three, below. As that section will describe, one way policy-makers can confront these economic barriers is by making it easier for charter schools to join together for the purposes of obtaining low-cost financing.

Tax-exempt equivalents

Tax-exempt financing is desirable, but there is nothing magical about it. Tax-exemption is just a way to obtain a lower interest rate on financing. Policy-makers might consider other ways of achieving the same objective. Here are two options:

- ◆ **Low-interest loan pools for charter schools.** In Chicago, the school district recognized charter schools' need for facilities funding and established a \$2 million pool of funds from which charter schools could borrow. Managed by the Illinois Facilities Fund (a nonprofit "community development financial institution," or CDFI), the pool offers loans with an interest rate of 5%. Though not tax-exempt, this source of financing provides schools with loans at rates considerably below what the market offers. State policy-makers could consider appropriating funds for similar pools elsewhere. As will be described in more detail under Strategy Three, such pools could also help address the risk issues faced by charter schools in the market for financing.
- ◆ **Tax credits for investments in school facilities.** The U.S. Congress recently created the Qualified Zone Academy Bond (QZAB) program (see box), which provides federal income tax credits for lenders that provide financing for schools. Because the tax credit is approximately equal to the interest they would have earned on the loans, lenders can offer the financing at no cost, or at a very low cost, to the borrower. State legislatures could establish similar tax credits, either for investments in public schools broadly (as with QZAB's) or for investments in charter schools specifically.

Qualified Zone Academy Bonds (QZAB's)

Schools in federal “enterprise communities” and those with student populations greater than 35% low-income are eligible to issue QZAB’s to pay for renovating facilities, purchasing equipment, developing materials, and training teachers. The school pays no interest on the bond. In lieu of interest, bondholders receive a federal tax credit equivalent to a federally set market rate of interest, currently about 5.6%. Each state has a certain amount of “QZAB authority” each year, ranging from half a million in less populous states to over \$50 million in California.

For more information about QZAB’s, visit the QZAB website (ed.gov/offices/OVAE/qzab.html) or contact Dr. Laurence Peters (202/401-0843).

Strategy Three: Create or Stimulate Finance Pools for Charter Schools

Part of Strategy Two is to solve a *legal* problem, guaranteeing charter schools access to certain types of financing. In practice, however, charter schools may face *economic* difficulties in actually tapping these sources. In line with the “risk challenge” described above, many charter schools may look too risky to potential investors to obtain the low-cost financing we see in traditional school construction. Investors may refuse to provide financing at all, or they may charge a steep premium that is unfeasible or that eats too deeply into charter schools’ operating budgets.

Traditional school finance avoids these problems with two mechanisms. First, school districts (or the entities that obtain financing for them) have the power to obtain the funds they need by taxing citizens. Second, school districts are virtually guaranteed of surviving from one year to the next as the primary providers of public education within their jurisdictions.

Policy-makers cannot hope to replicate these conditions for charter schools. Charter schools do not have taxing power, nor would it make much sense to grant it to them. And guaranteeing the survival of individual charter schools from one year to the next would undercut one of the fundamentals of the charter idea: the notion that a charter school that fails to deliver results or attract students must go out of business.

In order to level this playing field, then, policy-makers must find alternate ways of mitigating the risk of investing in charter schools. Strategy Three focuses on ways states can create finance pools to serve that purpose. It explains two models: direct loan pools and risk reserves.

Direct loan pools

The most straightforward version of this idea is simply to use public appropriations to create pools of funds that are then lent out directly to charter schools on favorable terms. The Chicago loan pool, introduced above as a way to provide low-cost capital to charter schools, is

also an example of how a public appropriation has mitigated charter schools' risk problems. Because the Illinois Facilities Fund received \$2 million from Chicago Public Schools, it is willing to engage in higher-risk lending than it ordinarily would. For example, IFF typically does not make loans to start-up enterprises, preferring to see a track record before extending financing. But in the charter school case, the public funding made it possible for IFF to lend to start-up charter schools. In addition to providing financing, the IFF also offered recipients much needed technical assistance on the "business" side of running a charter school. For more information, contact IFF's Joe Neri (312/629-0060).

While IFF is a rare example of a public-appropriation-funded charter school loan pool, the box contains several examples of privately funded efforts with a similar flavor.

Here are two issues to consider when establishing such pools:

- ◆ **Administration:** Who will manage the pool? Rather than undertaking the task itself, the Chicago Public Schools contracted with the Illinois Facilities Fund to administer the pool. Many other communities around the country have similar "community development financial institutions" or "CDFI's," which may be candidates for playing this role (for a list of CDFI's, see www.communitycapital.org). Alternately, a conventional bank might play the role — a bank, for example, manages the privately capitalized Texas Financial Foundation (see box). If such sources of expertise exist, it makes sense to look into tapping them rather than reinventing the wheel. Working with such organizations, of course, raises a host of issues, prominent among them compensation and accountability.
- ◆ **Restrictions:** Policy-makers need to consider what restrictions to place on the loan pool's use: eligibility requirements; restrictions on terms (rates, payback periods, collateral); and stipulations about legitimate uses of funds.

Privately Capitalized Charter School Loan Pools

Connecticut Health and Education Facilities Fund. CHEFA makes direct loans to Connecticut charter schools in amounts up to \$150,000. Loans are for five years with interest rates of 5.9%. Contact David Eikenberry (800/750-1862). For general information on CHEFA, visit the CHEFA website (www.chefa.com).

The Financial Foundation for Texas Charter Schools. Though the Foundation provides working capital rather than facilities loans, this \$3 million pool is a model for privately established charter loan funds. At a rate of 4-5%, the Foundation's loans are administered by a national bank. Contact Patsy O'Neill (210/348-7890) of the Charter School Resource Center of Texas. For general information about the Resource Center, visit its website (www.charterstexas.org).

National Cooperative Bank (nationwide). The National Cooperative Bank is a national lender to cooperative enterprises and nonprofit organizations. NCB has recently established a loan program for charter schools. Contact Kerine McNicholas (202/336-7729). For general information on the bank, visit the NCB website (www.ncb.com).

Prudential's Social Investments Program (New Jersey and selected cities). The Prudential Insurance Company's Social Investment Program has made more than \$6 million in loans to charter schools in New Jersey, with plans to offer the same program in other cities. Interest rates range from 2.5%-5% for working capital loans, and from 5-7.5% for long-term facilities loans. Contact John Kinghorn (201/802-6995). For general information about Prudential's Social Investments Program, visit its website (www.prudential.com/community/corporate/cmzcz1005.html).

Self-Help (North Carolina). Self-Help is a statewide nonprofit community development financial institution. Self-Help's focus is on providing access to capital to those who cannot obtain it through conventional sources. Through its "community facilities fund," Self-Help has made several loans to charter schools for facilities and other purposes. Creative deal structures and the use of federal loan guarantees have made it possible for Self-Help to assist schools that were "unbankable" at conventional institutions. Loans carry a market rate of interest. Contact Laura Benedict (919/956-4400) or visit Self-Help's website (www.selfhelp.org) and look for Community Facilities Fund.

Other providers. In addition to all of these nonprofit-oriented providers, there are also numerous for-profit lenders making financing available to charter schools for facilities.

Risk reserves and other "credit enhancement"

A more complex approach is to create pools of capital that are not themselves lent out, but which instead serve as "reserve" or "guarantee" pools for privately provided financing. Under such an initiative, a state appropriation would be held in escrow by a trustee. If a charter

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school that was part of the pool went out of business, investors could recoup what they were owed (perhaps over time) from the pool. Because only a small percentage of charter schools would be expected to fail, *one dollar placed into such a pool could potentially “leverage” several more dollars in private financing.*

While there are currently no working models of such a program in the charter arena, similar approaches have been successful in other domains. For example, North Carolina’s Self-Help (see loan pools box) operates a loan pool for child care centers in which state money forms the underlying guarantee. And similar arrangements are under development for charter schools. The Charter Schools Development Corporation in Washington, DC recently received federal funding to design an initiative called “Kinder Mae.” Initially focused on DC, the program may offer services such as loan guarantees, interest rate subsidies, and other instruments to help reduce the risk to private investors and lower the cost of financing to charter schools. For more information contact Richard Thompson (202/739-9630) or Mindy Kaiden (202/739-9796) or read more at Education Week on the Web (www.edweek.org/ew/vol-18/12chart.h18).

The same issues surrounding the creation of a direct loan pool — administration and restrictions — would apply to a risk reserves approach as well. In particular, policy-makers would need to consider how much leverage to seek with such a pool. On this question, policy-makers face a tradeoff between achieving leverage and reaching deeply into the charter school population. Charter schools vary greatly in the degree of risk they present to investors. Charter schools that are starting from scratch and do not have the backing of existing organizations or well-to-do individuals look the most risky; those converting existing schools or with ties to strong organizations or other “deep pockets” look less risky. In a pool made up of exclusively of the less risky deals, a dollar of reserve might leverage five to ten dollars in private financing. In a pool of the riskier deals, two-to-one leverage may be all one could hope for.

Supplementing state appropriations

The foregoing discussion treated these pools as if they would be wholly capitalized by state appropriations. But it may be possible to bring additional resources into the pools, through a couple of mechanisms:

- ◆ **Generating private matching funds:** As the experience in the box indicates, private charitable resources may also be available to capitalize these pools. One possibility is to use a public appropriation to stimulate private donations to a pool, generating matching dollars that stretch the impact of the appropriation. For example, a state could offer a tax credit for investments in such pools.
- ◆ **Using federal charter school funds:** Many states receive grants from the US Department of Education for charter schools. While most of this funding must be passed on to charter schools as grants, a portion may be used to capitalize finance pools for charter schools. California has established such a pool. For more information, contact Ging Tucker (916/324-4536) or read a memo describing the

program at the California Department of Education's website (www.cde.ca.gov/ftpbranch/retdiv/charter/revloan1.html).

Strategy Four: Provide Incentives for Organizations to Supply Facilities

State policy might also play the role of encouraging various organizations to provide facilities to charter schools at low costs. The obvious target of such policies in some places is local school districts that have vacant school space. In Washington, DC, for example, charter schools have had the opportunity to bid on favorable terms when vacant schools go on the market — obtaining space for perhaps 20% below the otherwise lowest bid made. While there have been numerous problems with this process (e.g. intricate bureaucratic process; some questions about how favorable the terms really are; the condition of the buildings), other jurisdictions could consider similar or better ways to require local school districts not to "sit on" existing space. As a starting point, DC's policy for disposing of surplus facilities is online (www.k12.dc.us/DCPS/policies/other_policies.html/disposition_amend.html).

Aside from local districts, other potential providers of space include:

- ◆ **Other government entities:** Public agencies could be required by law to offer vacant space to charter schools (and perhaps other nonprofit/public entities) on favorable terms. Some DC charter schools inhabit an "incubator" this fall managed by the nonprofit AppleTree Institute for Educational Innovation. The incubator is located in a former federal government facility leased to AppleTree under very favorable terms. Contact Jack McCarthy (202/775-5826).
- ◆ **Property owners:** Legislation introduced in North Carolina's general assembly would provide tax credits to property owners who donate space in certain areas to certain kinds of nonprofit organizations. For some properties, such a tax credit (in conjunction with other tax advantages of charitable donation) could make it economically feasible for the owners literally to give buildings to eligible recipients. While the NC legislation does not target charter schools, a similar structure could be arranged for charter schools (and perhaps conventional public schools as well). North Carolina Senate Bill 396 (1998) is available on the Internet (www.ncga.state.nc.us/html1997/bills/senate/sbil0396.full.html).
- ◆ **Employers.** Florida's charter legislation allows employers to reserve some school seats for children of employees if they invest substantially in school facilities. See Section 228.056(22) of Florida's charter law (www.firn.edu/doe/bin00038/chrtlegi.htm)
- ◆ **Developers.** Some advocates have proposed allowing real estate developers to do the same.

In the last two cases, one important policy issue concerns the degree to which set-asides of student seats for children of employees or residents of particular housing developments

undermines charter schools' open enrollment. Policy-makers have to balance the favorable effects on the facilities climate with the impact on open enrollment.

Strategy Five: Consider Other Ways to Improve the Facilities Climate

Strategy Five is less a “strategy” than a collection of measures state policy-makers could take to make it easier for charter schools to obtain suitable, affordable facilities. These include:

- ◆ **Addressing investors’ concerns about short charter terms:** Investors called upon to make 15-30 year commitments to charter schools are often concerned about the fact that the schools’ charters will come up renewal in 3-5 years. Some states (Arizona, the District of Columbia, and Michigan) have responded by lengthening the term of charters to as much as 15 years. Policy-makers in other states, though, regard such long terms as antithetical to the accountability of charter schools. Perhaps more important, though, is that *the renewal process and the criteria by which charter schools are judged be crystal clear*. Investors are willing to take on risk if they understand it; after all (as noted above), investors provide funds all the time to businesses with no “charters” at all. It is when the future seems *arbitrary* that risk assessment becomes difficult. State policy-makers can render the future less arbitrary by clarifying charter school accountability policies.
- ◆ **Property tax exemption:** If it is not already clear in state law, the state legislature could clarify that as public schools, charter schools are exempt from property taxes. Ideally, property owners leasing facilities to charter schools would obtain the same exemption and pass it on to the schools in the form of reduced lease payments.
- ◆ **Clarity regarding ownership:** While some argue that charter schools are generally better off leasing, some schools may find it financially advantageous to own. Ownership heightens the policy issue of what happens to the school's assets in the event the school fails — NC, for example, has all "net" assets (that is, after creditors have been repaid) go to the local school district where the charter operated.
- ◆ **Enabling conversions of existing schools:** Some charter school laws allow existing public and private schools to convert to charter status. One advantage of conversions is that they may already have a suitable facility in place. States that disallow conversions can ease their facility problems by making conversions possible.

Beyond State Policy: Additional Strategies to Address the Challenge

The foregoing pages have suggested that state policy can play a useful role in easing the facilities finance challenge for charter schools. But state policy is just one tool available to address these issues. The Charter Friends National Network is pursuing a variety of these additional tools, some of which will be the subject of additional publications. A brief summary, though, will help round out this discussion of the role of state policy:

- ◆ **Federal policy:** The US Congress has recently considered legislation to provide federal funding and/or tax incentives for the construction and renovation of school facilities. As with other federal programs, any such initiatives should be framed in a way that charter schools have full access to an appropriate share of the benefit.

- ◆ **Local policy:** Though some states prohibit local government from providing capital to charter schools directly (see Strategy Two), many others do not. In these states, city and county governments can be enormously helpful to charter schools in many ways, including facilities financing. Cities in Florida, for example, have issued tax-exempt bonds to raise funds for charter school facilities, to be repaid by the charter school on favorable terms. Even in states where direct provision of funding to charter schools by cities and counties is not allowed, local governments can be on the lookout for ways to include charter schools in broader revitalization efforts. Jersey City, for example, leased space to a charter school in a major downtown development project financed with city bonds. Federal community development block grant funds in Washington, DC have been pledged for the charter school incubator described under Strategy Four. Charter schools in Minnesota have tapped existing city revolving loan pools for community development.

- ◆ **Friends group activities:** Most charter states are home to one or more “charter friends organizations” (such as charter school resource centers) that provide support to the charter movement (for a list, see the Charter Friends National Network’s website at www.charterfriends.org/contacts.html). In addition to making policy-makers aware of the options outlined in this report, these organizations can play many roles in helping address the facilities challenge (see box).

Ways Friends Groups Can Help Address the Facilities Challenge

- ✓ **Information:** disseminating information to charter schools about creative financing arrangements
- ✓ **Recruiting founders:** recruiting existing organizations (including existing schools where conversion is allowed) to start charter schools, since existing organizations may have facilities to use or be in a good position to obtain financing because of their history
- ✓ **Needs assessment:** conducting statewide facilities needs assessments to inform policy-makers and the private sector
- ✓ **Fundraising:** raising private funds for the sort of pools described under Strategy Three
- ✓ **Finance pool organizing:** serving as organizers of these pools — marketing the availability of funds, helping charter schools apply, recruiting investors
- ✓ **Recruiting volunteers:** mobilizing “pro bono” services (attorneys, financial advisors, etc.) to help lower the transactions costs of financing and to ensure charter schools have access to expertise
- ✓ **Business-side assistance:** helping make charter schools more attractive to investors by getting “the business side” of their operations in order through trainings, materials, and one-on-one help.
- ✓ **Brokers:** serving as brokers between charter schools and the many emerging private providers of capital, as well as helping charter schools become intelligent customers of these services

- ◆ **Creative responses by charter schools:** As this report noted at the outset, charter schools have responded to these challenges in hundreds of creative ways, and they will continue to do so. As with many aspects of the charter school world, public policy can only go so far to guarantee good outcomes. The rest falls on the shoulders of charter school entrepreneurs and their problem-solving capabilities.

Conclusion and Next Steps

The Charter Friends National Network offers these strategies as part of a broader effort to improve charter schools’ access to suitable facilities nationwide. In addition to making these policy recommendations, the Friends Network is also working with friends organizations in several states to pursue other approaches to “paying for the charter schoolhouse.” If you have questions about the Friends Network’s activities, suggestions for future initiatives, or would like to receive updates as this initiative moves forward, please contact Bryan Hassel (704/370-0357).

Appendix A: How States Handle Per-pupil Facilities Funding for Charter Schools

State	Annual amount per pupil (approx)	Basis for amount	Source	Flexibility	Incentives for Economy	One-time funding for capital?
<i>Arizona</i>	\$900-\$1,200	charter capital needs and amount received by school districts for capital	follows the child from the district of residence	schools may spend funds for any legitimate purpose	funds not expended on facilities available for other uses	no
<i>DC</i>	\$600	approx. 60% of per pupil capital expenses in district	federal appropriation	schools may spend funds for any legitimate purpose	funds not expended on facilities available for other uses	no
<i>Florida</i>	\$387-\$587*	1/30 of official state cost of new school construction	state appropriation	schools may use funds to pay for capital-related expenses only	none	yes - one-time payments of \$5,800-\$8,800 per pupil**
<i>Massachusetts***</i>	\$260	per pupil state capital expenditure	state appropriation	schools may spend funds for any legitimate purpose	funds not expended on facilities available for other uses	no
<i>Minnesota</i>	up to \$465 in building lease aid plus \$168 in other funds	average per pupil funding for district capital expenditures	state appropriations	schools may only spend funds to pay leases	state reimburses only 80% of actual lease cost, up to maximum	no
<p>* Florida's annual funding ("PECO" funds) is only available to schools beginning in their third year of operation.</p> <p>** Districts can apply for these funds if district students attend charter schools in non-district facilities. Charter schools must negotiate a share of the funds districts receive. Per pupil amounts are \$5,800 for elementary, \$6,650 for middle, and \$8,800 for high.</p> <p>*** Massachusetts' funding is a one-time appropriation for 1998-99.</p>						

Appendix B: Resources on Charter School Facilities Finance

Other studies of charter school facilities issues

Massachusetts Charter School Resource Center, *Charter School Facility Financing: Constraints and Options* (February 1998). Available from the Pioneer Institute (617/723-2277).

RPP International, *A National Study of Charter Schools: Second Year Report* (1998), pp. 91-105. Available online (ed.gov/pubs/charter98).

Chester E. Finn, Jr., Bruno V. Manno, Louann A. Bierlein, and Gregg Vanourek, "The Birth-Pains and Life Cycles of Charter Schools," Part II of *Charter Schools in Action Final Report* (1997). Available online (edexcellence.net/chart/chart2.htm) or by calling the Hudson Institute (800/483-7660).

Legislation

Arizona (annual per-pupil funding for facilities)

Contact

John Schilling
AZ Department of Education
602/542-5754

Links to Legislation

www.azleg.state.az.us/ars/15/185.htm
www.azleg.state.az.us/ars/15/185-01.htm

[Note: amendments in 1998 added to the amounts specified in these statutes]

Colorado (tax-exempt bonds for charter schools)

Contact

Mark Gallegos
Colorado Educational and Cultural Facilities Authority
303/297-7332

Links to Legislation

www.state.co.us/gov_dir/leg_dir/sess1998/sbills98/sb082.htm

District of Columbia (annual per-pupil funding for facilities)

Contacts

Nelson Smith
The District of Columbia Public Charter School Board
202/887-5011

Joseph Carrillo
DC Charter Schools
202/442-5183

Florida (annual AND one-time per-pupil funding for facilities; workplace charters)

Contact

Cathy Wooley-Brown
FL Charter School Resource Center
813/974-3700

Links to Legislation

One-time per-pupil funding (SIT Fund) — two sites:

http://www.leg.state.fl.us/citizen/documents/statutes/1998/ch0235/SEC2155_.HTM#0235.2155 [note: this address is one continuous string]

http://www.leg.state.fl.us/citizen/documents/statutes/1998/ch0235/SEC216_.HTM#0235.216 [note: this address is one continuous string]

Annual per-pupil funding — see section 228.0651 of the charter law:

<http://www.firn.edu/doe/bin00038/chrtlegi.htm>

Charters in the workplace — section 228.056(22) of the charter law (above).

Massachusetts (annual per-pupil funding for facilities)

Contact

Scott Hamilton
Massachusetts Department of Education
617/727-0037

Minnesota (annual per-pupil funding for facilities)

Contact

Gary Farland
Minnesota Department of Children, Families, and Learning
651/582-8200

Links to Legislation

Building Lease Aid:
www.revisor.leg.state.mn.us/stats/124D/11.html

To read more

Charter Friends National Network's write-up on Building Lease Aid, online:
www.charterfriends.org/mnfacilities.html

North Carolina (tax-exempt bonds for charter schools)

Contact

Jones Norris
NC Educational Facilities Finance Authority
919/715-3730

Links to Legislation

www.ncga.state.nc.us/html1997/bills/ratified/senate/sbil1556.full.html

Charter school loan pools and credit enhancement programs

California Department of Education Charter School Loan Pool

Contact Ging Tucker (916/324-4536)
Read more online at (www.cde.ca.gov/ftpbranch/retdiv/charter/revloan1.html)

Charter Schools Development Corporation (Kinder Mae)

Contact Richard Thompson (202/739-9630) or Mindy Kaiden (202/739-9796)
Read more at Education Week on the Web (www.edweek.org/ew/vol-18/12chart.h18)

Connecticut Health and Education Facilities Fund

David Eikenberry (800/750-1862)
For general information on CHEFA, visit the CHEFA website (www.chefa.com)

The Financial Foundation for Texas Charter Schools

Contact Patsy O’Neill (210/348-7890) of the Charter School Resource Center of Texas
For general information about the Resource Center, visit its website
(www.charterstexas.org)

Illinois Facilities Fund

Contact Joe Neri (312/629-0060)

National Cooperative Bank

Contact Kerine McNicholas (202/336-7729)
For general information on the bank, visit the NCB website (www.ncb.com)

Prudential’s Social Investments Program

Contact John Kinghorn (201/802-6995)
For general information about Prudential’s Social Investments Program, visit its website
(www.prudential.com/community/corporate/cmazz1005.html)

Self-Help

Contact Laura Benedict (919/956-4400)
Visit Self-Help’s website (www.selfhelp.org) and look for Community Facilities Fund

Other initiatives and resources

Qualified Zone Academy Bond program

Contact Dr. Laurence Peters (202/401-0843)
QZAB website ed.gov/offices/OVAE/qzab.html

DC Public Schools Policy on disposing of surplus facilities

online at: www.k12.dc.us/DCPS/policies/other_policies.html/disposition_amend.html

AppleTree Institute Charter School Incubator (federal community development funds; low rent in surplus government office space)

Contact Jack McCarthy (202/775-5826)

National List of Charter School Friends Organizations

Online at www.charterfriends.org/contacts.html

Public Impact for Charter Friends National Network 1999

National List of Community Development Financial Institutions

Online at www.communitycapital.org