CHARTER SCHOOLS DEVELOPMENT CORPORATION

National Demonstration Program Proposal
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PROGRESSIVE POLICY INSTITUTE

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PROPOSAL

That Congress authorize and appropriate a multi-state national demonstration project for the credit enhancement of public charter schools. The initial appropriation shall be the greater of 10% or $100,000,000 of the total funding provided by the Congress for general public school facilities assistance in federal fiscal year 2001, including charter schools facilities financing, and such sums as Congress may authorize and appropriate in subsequent years.

Such demonstration project funding shall be deducted or "set aside" from any general federal facilities assistance provided for public schools, regardless of whether federal funding is distributed to eligible entities in the form of competitive grants by the U.S. Department of Education or distributed to states using an inter-state and intra-state formula-based system.

Such demonstration project funding shall be appropriated to the U.S. Department of Education which, in turn, shall contract through the Office of Charter Schools or other appropriate agency with a non-profit, tax-exempt organization, whose mission is to provide public charter schools with facilities and financing assistance, for the purposes of conducting the national demonstration project and providing credit enhancement for public charter schools.

In selecting an organization(s) to conduct a multi-state demonstration project, the Department shall give preference to any organization with a history and proven record of providing credit enhancement services for charter schools. The Department shall give added preference to any organization that has already been authorized and funded by the Congress to conduct such activities in the District of Columbia and the states that have charter school laws.

Such proposal should be part of any compromise between the Clinton Administration and the Congress providing expanded federal facilities financing for K-12 public schools. (Note: The Kiplinger Letter recently predicted that the Clinton Administration "will get at least $1 billion for spending on school construction." In addition, Congressman Bill Goodling (R-PA), Chairman of the House Education & Workforce Committee, recently introduced legislation [H.R. 4766, the "Classroom Modernization Act of 2000"] authorizing a new $1.5 billion federal facilities funding program for all public schools, including charters.)

In response to these developments, the Charter Friends National Network recently wrote:

> "Since charter school funding is largely a state issue, it makes sense for the federal government to try to encourage states to address this problem. One way to do so is to provide funding for state or multi-state efforts to open up charter schools' access to private capital. For example, state educational agencies or **non-profit organizations** could receive pools of funds to use as reserves against losses incurred by private providers of financing to many charter schools.
>
> "The existence of such reserves would make finance providers more willing to work with charter schools, and to do so at lower rates of interest. By awarding funds to initiatives that promise **innovative** approaches, a high degree of **leverage** of private funding, and

the possibility of **replication** in other states, Congress could serve as a catalyst for efforts to address this problem all over the country (emphasis in original) . . .

"If even a small amount of federal funds can be used to help stimulate the development of programs that effectively leverage private funding for the construction and renovation of charter school buildings, these programs can be expanded not just to benefit other charter schools, but to help all public schools tap new resources for school construction. Just as charter schools are pioneering new models of teaching and governance that may be widely applicable to public schools, charter schools can serve as the 'R & D Lab' for new approaches to facilities financing, as well." (Charter Friends National Network Federal Policy Update, June 29, 2000)

CHARTER FRIENDS NATIONAL NETWORK

FEDERAL POLICY UPDATE

A periodic update on federal legislation and policy of interest to charter schools

Jon Schroeder, Project Director

June 29, 2000

Goodling bill may open door to federal/state role in charter facilities financing

As facilities financing has emerged as one of the central issues facing public charter schools, several initiatives have been proposed to create federal programs or loan guarantees to help charter schools finance their facilities. Previously, Representative Heather Wilson (R-NM) introduced legislation creating a new $1.5 billion federal loan guarantee program for charter facilities. And the presumptive Republican Presidential candidate, Texas Governor George W. Bush, has proposed a "Charter School Homestead Fund" to provide $3 billion of loan guarantees to help establish or improve 2,000 charter schools nationwide in two years.

Most recently, more general federal facilities legislation was introduced by Representative Bill Goodling (R-PA), chair of the House Committee on Education and the Workforce. The Goodling proposal -- H.R. 4766 -- authorizes a new $1.5 billion federal facilities funding program for all public schools, including charters. From a political standpoint, the Goodling proposal is significant in that it reverses historical opposition by most Congressional Republicans to any federal role in financing K-12 school facilities. The Goodling bill is being viewed as a starting point for serious negotiations on this issue with Congressional Democrats and the Clinton Administration, which has placed a high priority on including at least some support for facilities financing in an expanded federal role in K-12 education. For more information on Representative Goodling's proposal go to http://edworkforce.house.gov/press/cmaintro62700.htm

The Goodling bill is significant in that it explicitly includes charter schools in defining eligibility for federal facilities support. In fact, it gives charters preference over some other potential uses and includes criteria states may use to determine priorities that favors smaller, innovative schools and schools that involve partnerships and co-locations with other tenants -- both strategies that many charters have used to hold down costs and strengthen their educational offerings. In addition, the Goodling bill allows states to create loan guarantee programs that could support efforts at the state level to help charters access lower cost financing for facilities.

Questions and answers on charter facilities financing and defining a federal role

To help inform the growing interest in a federal role in facilities financing, this "Federal Policy Update" addresses some of the commonly asked questions about the facilities financing needs of charters and the potential for a federal role in meeting those needs. In addition, it includes a summary of Representative Goodling's proposal, with special attention to its charter provisions.

Q. Why do charter schools need help with facilities financing?

A. Financing a school facility is much like financing a home — one needs access to both *upfront capital* to make a purchase or complete some renovations and an *ongoing source of funds* to pay off one's loan or lease. District schools have both. Their parent districts have the right to issue tax-exempt bonds backed by their property wealth. And, they have the right to levy property taxes to pay off whatever debt they incur. This combination of bonding and taxing authority generally gets

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districts very low interest rates on any borrowing they do -- significantly reducing the short and long-term cost of their facilities.

Charter schools, on the other hand have neither bonding nor taxing authority. Few states provide charters alternative sources of upfront capital for their facilities, and many make it difficult for charter schools to tap the tax-exempt bond markets that districts use to finance buildings. Finally, only a handful of states provide any ongoing funds for buildings, requiring charter schools to pay capital expenses out of dollars meant for the classroom.

Q. <u>What are the consequences of charter schools facilities financing problems</u>?
A. A host of difficulties result from failure to address the facilities financing challenge:

- Charter schools are forced to spend operating funds -- intended to pay for teachers, books and other educational necessities -- on their buildings. In Colorado, for example, the average charter school -- which has 260 students -- is spending the equivalent of about 2.5 teaching positions on its rent. In Minnesota, the average annual rent for charter schools is about $175,000 -- enough money for a school to purchase a fully operational network of 100 computers *each year*!
- Charter school leaders spend an inordinate amount of time dealing with facilities issues — time they could be spending on improving student achievement
- Charter schools often find themselves in buildings that are too small or inadequately configured for their educational programs.
- Some promising charter schools never even open because of the challenges of finding a facility they can afford.

Q. <u>What kinds of charter schools face the most difficulties in facilities financing</u>?
A. Schools started by parents, teachers, and residents of low-income communities face the greatest challenges because they generally lack the personal or institutional wealth to finance facilities themselves. They may also lack connections to people in the financial world who can help them overcome these problems. Consequently, <u>inadequate facilities financing is an equity issue</u>, threatening to limit the ability of grassroots groups to start viable charter schools.

Q. <u>Why should the federal government get involved in charter school facilities financing? Shouldn't states be handling this</u>?
A. Ultimately, states should resolve charter schools' facilities financing problems by ensuring that charter schools have access to capital and ongoing funds to pay off debt or pay leases. The federal government should certainly not try singlehandedly to "solve" the facilities financing problem for charter schools. But Congress can play a leadership role, encouraging states to take action in this area through two channels: (1) by funding the development of new strategies that states can adopt or adapt, and (2) by providing incentives for states to treat charter schools fairly.

Q. <u>What are some of ideas about how the federal government could address the charter school facilities financing challenge</u>?
A. Several different proposals have been floated for a limited federal role in charter school facilities financing, including:

- ensuring that charter schools are *eligible* for any general federal facilities assistance

provided for all public schools;
- providing federal funding for state-based or multi-state *demonstration projects* that provide "credit enhancement" for charter schools; and
- establishing *federal guarantees* of private debt taken on by charter schools.

Q. Wouldn't charter schools have a fair shot at any general public school facilities assistance provided by the federal government? Why make a special effort to ensure that charter schools are eligible?

A. Even if charters are *technically* eligible, there may be barriers to their receiving any funds. In some states, charter schools are considered "local educational agencies" (LEA's), or school districts in their own right. In these states, charter schools would compete against other school districts for any federal facilities funds. Since school districts tend to have large capital needs and greater political power than charter schools, charter schools would usually be at a distinct disadvantage in any statewide competition for funds.

In other states, charter schools are part of existing LEA's. In those states, charter schools would have to compete against district schools, many of which face severe facilities challenges. It is also likely that most districts would favor "their own" schools over charter schools.

Charter schools might fare better in a formula-based system, but such a system would have to be designed with care to ensure that charter schools are treated fairly. For example, a state formula that favored districts with low property wealth might cut out a charter school that serves poor students within in an otherwise wealthy district.

Q. How could policymakers ensure charter schools have a fair chance of accessing broader programs of federal assistance for facilities?

A. Congress could take several steps to ensure that charter schools are treated fairly, including:
- explicitly mentioning that charter schools are eligible for any federal facilities funding;
- requiring states to allocate a pro-rata share of funds for their charter schools;
- requiring smaller levels of matching funds for dollars provided to charter schools;
- mandating that states use criteria that serve wider public policy purposes but also favor charter schools, like
  - ✓ favoring schools and districts with small or nonexistent tax bases;
  - ✓ favoring small schools, which research has shown to be more effective;
  - ✓ favoring schools pursuing cost-efficient facilities approaches, like sharing multi-use space or entering into partnerships with employers and others;
  - ✓ favoring school construction projects that will contribute to the revitalization of distressed neighborhoods and communities;
  - ✓ favoring schools pursuing innovative educational programs.

Q. How could federally funded demonstration projects help address the charter school facilities financing challenge?

A. Since charter school funding is largely a state issue, it makes sense for the federal government to try to encourage states to address this problem. One way to do so is to provide funding for state or multi-state efforts to open up charter schools' access to private capital. For example, state educational agencies or nonprofit organizations could receive pools of funds to use as reserves against losses incurred by private providers of financing to many charter schools.

The existence of such reserves would make finance providers more willing to work with charter schools, and to do so at lower rates of interest. By awarding funds to initiatives that promise *innovative* approaches, a high degree of *leverage* of private funding, and the possibility of *replication* in other states, Congress could serve as a catalyst for efforts to address this problem all over the country.

Q. Why should the federal government make a special effort help charter schools (which educate just 1% of students) with facilities issues when there are so many district public schools with facilities in need of repair?

A. Paying special attention to charter schools' facilities needs make sense for two reasons. First, state policies generally place charter schools at a disadvantage when it comes to facilities financing. Just as the federal charter school grant program has helped remedy a lack of state-provided start-up funds for charter schools, federal facilities assistance could help address this nationwide equity issue for charter schools.

Second, limited federal funding for charter school facilities can be an *investment* that yields benefits for all public schools. Figuring out how to finance school buildings is a critical challenge for all of public education. Because of unfavorable state policies, charter schools have had to be the most creative in addressing this challenge, including establishing partnerships with businesses or other non-profits and co-locating with other tenants.

If even a small amount of federal funds can be used to help stimulate the development of programs that effectively leverage private funding for the construction and renovation of charter school buildings, these programs can be expanded not just to benefit other charter schools, but to help *all* public schools tap new resources for school construction. Just as charter schools are pioneering new models of teaching and governance that may be widely applicable to public schools, charter schools can serve as the "R&D lab" for new approaches to facilities financing, as well.

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SOLVING THE CHARTER SCHOOL FINANCING CONUNDRUM

Charter schools are an important component of education reform. Unfortunately, charter schools often have difficulty obtaining capital financing and the funds needed to cover initial operating expenses and other start-up costs. This one of the most challenging obstacles that charter schools face, but state legislators can make it easier. They can advance education reform by implementing favorable charter school financing policies. Here are some policies lawmakers should consider implementing in their states to alleviate financing burdens on charter schools.

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Charter schools in many states rely heavily on grants from a federally authorized fund called the *Public Charter Schools Program.* Often in these states, this federal grant money is the only source of start-up funding available to charter schools. This should not be the case. There are several policy options available to the states that can provide the funding and the flexibility necessary to foster new charter schools. Some of these policy strategies are outlined by the Charter Friends National Network 1999 publication, *Paying for the Charter Schoolhouse* (www.charterfriends.org).

Four Ways to Improve Charter School Finance

1. **Provide alternative sources of cash flow, other than per pupil spending, to be used expressly for the purposes of capital and start-up costs.**

   This payment can be based on projected attendance and should be scheduled to arrive early enough to cover capital and start-up costs. Legislators must also be sure to equalize per pupil funding between charter and non-charter public schools.

2. **Allow charter schools to take advantage of the same tax-exempt and low-cost financing that is available to more traditional institutions.**

   Typically, school districts finance new facilities and capital needs by selling tax-exempt bonds that are backed by the faith and credit of a local authority, usually the government. State lawmakers can legally define charter schools so that they can take advantage of this financing option. State lawmakers can also provide tax breaks for those who lease facilities to charter schools wherein the benefit is returned to the charter school in the form of lower lease payments.

3. **Encourage the growth and expansion of specialized loan programs and financing pools that lend money to charter schools on favorable terms.**

   Legislators have the power to create loan programs and financing pools. They can appropriate funds from the state budget to these new financing pools, pre-existing financing pools, or loan programs. They should also encourage other investors to contribute to these loan programs and pooled sources of funds.

4. **Consider ways to improve the viability of charter schools as an investment opportunity and find ways to encourage organizations to lend support to the charter school.**

   Investors are leery of charter schools because they are public institutions with low earning potential and futures dependent upon performance. Good charter laws will provide incentives that encourage public and private organizations to work with charter schools. These incentives should include tax breaks for investors.

WHERE THESE SOLUTIONS ARE AT WORK

1. **Sources of Cash Flow**

   Federal and private grants are welcomed but insufficient and charter schools should not rely upon them. To provide sufficient aid, state legislators are amending their charter laws so charters can access state funds to pay for more costly capital and start-up costs. Many states have begun to offer grants and/or increases in per-student allocations that are to be used for such capital expenses as facilities, purchases and renovations or construction. The states that have adopted this strategy are blazing a trail that charter advocates and lawmakers in other states should follow.

   - **Arizona** provides access to grants from a Stimulus Fund that was established in the State Treasury specifically for the use of charter schools. The State Department of Education administers this fund that can be used for start-up costs, as well as for the cost of renovating or remodeling buildings. Qualifying schools may receive an initial grant of up to $100,000 during or before their first year of operation and schools that received an initial grant may apply to receive an additional grant of up to $100,000.[i] Arizona also provides an additional $400 per student to charter schools for both capital and operational funding to help equalize their revenue. In Fall 2000, all public schools will receive an additional $350 per student.

   - In 1999, the **Minnesota** legislature moved to provide additional support for charter schools. Charter schools in their first two years of operation may receive grants in the amount of $50,000 per school or $500 times the number of students served, whichever is greater. The state's Department of Children, Families and Learning must provide the grant within 45 days of the first day of school.

To assist with lease payments, the state provides "lease aid." Charter schools may apply to the state for building lease aid when, one the one hand, they determine that it may economically advantageous to lease a building or land and, on the other, the school's total operating capital revenue is insufficient to cover the lease payments. The program provides to charter schools no less than 90 percent of the cost or $1,200 per student, whichever is smaller. New schools are to receive ten percent of this lease aid by July 15th every year.[ii]

- **Massachusetts** makes competitive grants available to charter schools for planning, developing, and leasing and/or constructing facilities. Charter schools can also apply *Goals 2000* funds and other federal sources of money to cover start-up costs. In 1998-99 school year the state provided an additional one-time appropriation of $270 per student specifically for facilities.[iii]

- **Florida** is one of the few states that incorporates capital and facility expenses into its charter law. Charter schools receive one-fifteenth of the capital cost per pupil allocated by the state for specific grade levels.[iv] Charter schools also receive monies to purchase property, conduct construction or renovations, or to make lease payments through its School Infrastructure Thrift (SIT) Awards. Once a charter school reaches its third year, it may receive monies from the Public Education Capital Outlay (PECO) and Service Trust Fund.[v]

- **Utah** makes grant monies available to charter school for start-up costs at the discretion of the Superintendent of Public Instruction. Once a charter school has secured a facility in the form of a written agreement for the use of space, the Superintendent can then award a one-time grant to the charter school of $62,500.[vi]

- **New York's** 1998 charter law created a Charter School Stimulus Fund to assist schools with start-up and facilities costs, which in 1999, began with $1 million.

- The **District of Columbia** provides $600 per student, which is 60 percent of the District's per pupil capital expenses. Moreover, although it is the responsibility of the District to provide charter schools with preferential bidding rights for vacant public school space, this task has proved daunting.

2. Access to Tax-Exempt/Low-Cost Financing

Perhaps the most efficient and most effective way to help charter schools obtain much needed capital is in providing access to tax-exempt bonds.[1] The sale of tax-exempt bonds helps with the financial needs of schools. The interest payments on these bonds are not subject to federal income tax, and, in some cases, state or local income tax, making the project more financially feasible. Two policy approaches of this kind of financing exist: **direct and indirect.** State should also consider creating **tax credits** for the landlords of charter schools.

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[1] A bond is a formal certificate of indebtedness issued by governments or business corporations in return for loans. It bears a fixed rate of interest and promises to repay the funds borrowed after a certain period, usually 10 years or more. Bonds issued by city and state governments are exempt from federal income taxes.

Direct financing allows charter schools to issue bonds on their own behalf, rather than going through a special bond issuer, thereby eliminating transaction costs. In order to utilize direct financing, however, charter schools must attain "public agency" status as defined by the IRS. Traditionally, public agency status requires substantial control by the state. Charter schools are unusual in that they are public agents, but are not controlled by the state. Therein lies a legal ambiguity that lawmakers will need to clarify.[vii]

Indirect financing allows states to create and fund new bonding authorities that can lend to charter schools with tax-exempt status. The authority (such as a local government) sells the bonds for the school and then transfers the proceeds to the school for its capital needs. The school then assumes the debt and must repay it with interest. Again, since the income that the bonds' buyers would earn from the bond is tax-exempt, the bonds can remain attractive to investors, even with a lower interest rate. Lower bond interest rates translate into lower interest payments for the charter schools.

In providing easier access to financing, legislators must be aware if their state is a Dillon Rule state. The Dillon Rule says that unless a public agency is explicitly allowed to take an action, it cannot take such action. This rule could prevent bond authorities from issuing bonds to charter schools, since they are not expressly allowed to do so. To resolve such issues, states legislatures must explicitly authorize bond-issuing authorities to issue bonds on behalf of charter schools as **Colorado, North Carolina,** and **Arizona** have done.

- In 1998, **Colorado** expanded the list of eligible beneficiaries of the new Colorado Education and Cultural Facilities Authority. This list now includes organizations with "an educational program pursuant to a charter from a school district." In 1999 Colorado also gave charter schools direct access to bonds at a public rate by defining charters as a "governmental agency." The Colorado Department of Education has also recommended that the legislature provide institutions of higher education specific authority to construct associated charter schools with their capital funds. This recommendation was modeled on the University of North Carolina's Lab School in Greeley, **North Carolina**. The school has been in existence for over 100 years, but only recently converted to charter school status.[viii]

- In 1998, **North Carolina** expanded its Educational Facilities Finance Agency to include non-profit organizations providing K-12 public education. The authority can now sell bonds for charter schools and then transfer the proceeds to the school for its capital needs.

- In **Arizona**, non-profit charter schools may apply for financing from Industrial Development Authorities (IDAs).[ix] IDAs lend the proceeds from a bond sale to qualifying groups that now include public charter schools. In March 2000, Arizona began to demonstrate how such a program would work. The Maricopa County Industrial Development Authority pooled the proceeds of a $27 million bond sale, the first such pool to come to market in the nation. By pooling the financing to accommodate the combined needs of seven charter schools, the Maricopa IDA was able to earn an investment-grade rating of Baa3 on the debt from Moody's Investors Service. Debt proceeds will be distributed to the seven schools, five of which are located within the metropolitan Phoenix area. "The benefit is that they can share the cost of issuance and that they can basically support each other financially at some level," Charles Lotzar, bond counsel with Kutak Rock, told the *Bond Buyer*.[x] According to Yaffa Rattner, a vice president with Moody's, this is important because, "as the charter schools' need to increase their access to the capital market [grows,] financial advisers, underwriters, and bond counsels will need to, in some instances, come up with structures that enhance the credit quality of an individual charter."[xi]

Legislatures should consider providing local government agencies incentives to provide indirect financing to charter schools. The more agencies that are willing to provide indirect financing the more likely it is that charter schools will receive the best rates available and that the ability of the charter schools to make informed decisions will improve.[xii] Competition that drives rates down and produces more information for consumers must always be encouraged.

- For example, in **Colorado**, the Education and Cultural Facility Authority has the authority to issue bonds on behalf of charter schools. They are the only authority that may do so, and this creates high transaction costs in terms in process paperwork and delays. If the legislature provided cities or counties with the authority to issue bonds then the charter schools would be able to choose the most economical and consumer friendly option.

Tax Credits: While these solutions do not entirely solve the facilities crisis of charter schools, used wisely, they can help make a significant dent in the financing burden. Policy makers can also provide a variety of tax incentives that ease the difficulty of obtaining capital financing. For example, charter schools may be exempt from local property taxes. Landlords who lease property to charter schools can obtain this tax exemption and pass the savings onto the schools.

- In **Florida,** charter schools are exempt from ad valorem taxes. The owner of the property is directed to work with the charter school to ensure that the school receives the benefit of the tax break through annual or monthly credits to the school's lease payments.[xiii]

3. Specialized Loan Programs and Financing Pools

Specialized Loan Programs: The creation or expansion of specialized loan programs, specifically for charter schools, would also expand access to low cost financing, thereby providing charter schools with additional funds with lower interest rates. Today, there are two major strategies being employed to create this funding avenue: **individual loans** and **pooled financing.**

Governments or private organizations can create **individual loans** tailored to the charter school's needs. Charter schools can dip into this pool for loans to help bridge their financial gap; and as charter schools become successful and pay off their loans with nominal interest, these programs grow and offer financing opportunities for more charter growth. State and private agencies in **Louisiana, New Jersey,** and **Texas** are developing this approach.

- In **Louisiana**, certain classes of charter schools may apply for an interest free loan of up to $100,000 that is payable over three years. Charter schools can use the money for purchases of equipment and other material items that may become the loan's collateral if other collateral has not been secured. Should a charter school default on the loan, the items purchased by the loan are transferred to state ownership.

- The Prudential Foundation's Charter School Lending Program, founded in January 1997, assists thirteen **New Jersey** charter schools cover their start up and early operating costs. Schools qualify by submitting a developed business plan to the foundation that demonstrates the ability to generate revenue and control expenses. Loans are secured and carry at an interest rate of 2.5 percent to five percent, considerably less than market rates. The loan amount is based on school enrollment with a maximum of $1 million and can be used for leasehold improvements and start-up costs rather than major capital expenses such as construction or purchase of facilities. Schools can also receive the loans as many as seven months ahead of the planned opening date with multiple withdrawals, giving the school more flexibility with which to secure start-up needs. By offering this loan with low interest rates, the Foundation helps charter schools establish much needed credit history.[xiv]

- In **Texas**, the Financial Foundation for Texas Charter Schools was established to provide capital funds for the early stages of charter schools. The foundation has already raised $3.27 million for its mission from the Texas banking and business communities. Eighty percent of that is the form of loans and twenty percent in the forms of grants. In 1999, 29 charter schools received loans at six percent (subject to change) for working capital.[xv]

- At the national level, the National Cooperative Bank (NCB) provides financing for improvements, construction expansions, acquisitions, equipment, and for the short-term working capital needs of charter schools through the Bank's nonprofit affiliate, NCB Development Corporation.[xvi] NCB is working in **California, Colorado,** the **District of Columbia, Minnesota, North Carolina,** and **Pennsylvania,** and has six closed loans, with many more committed and pending.

Lawmakers can ease the process of loan acquisition by helping charter schools accumulate the collateral with which to secure loans. For example, legislators can authorize charter schools to own property. They can promote work-place-charter schools like **Florida's** charter school law promotes. The state encourages charter schools to increase business partnerships, reduce school and classroom overcrowding, and transfer the burden of high facility costs to their business partners. They can also require that vacant public space be made available to charter schools at a discount rate. Not only does this provide charters with needed collateral but it also promotes neighborhood development and community investment.

Pooled Financing is a loan program that, as the title implies, gathers money and then lends it to charter schools on favorable terms. The idea is to have non-profit community developers create a fund to which investors, private donors, and public appropriations can contribute. Community developers are then able to lend money from the pool to charter schools that may not be able to strike a deal elsewhere. Since such community developers cannot turn a profit, they administer the loans at a lower interest rate.

- In **North Carolina**, a non-profit program titled Self Help administers the North Carolina Community Facilities Fund, which is used for community and charter school development. Loans of up to $1 million are available with favorable terms such as fixed-rate borrowing for large projects.[xvii]

- The **Chicago** Public School District invested $2 million in a fund maintained by the Illinois Facilities Fund (IFF), a non-profit community developer. The IFF now lends out this money at a modest five percent interest rate.[xviii]

- In **California**, the California Charter School Revolving Loan Fund provides interest free loans of up to $250,000 to help start up charter schools with capital and other needs. The fund is comprised of federal funds obtained by the state for charter schools and any other funds appropriated or transferred to the fund through the annual budget process. As of October 1, 1999 a total of approximately $5.5 million was available for loans from this fund.[xix]

- A twist on the pooling idea is to combine charter schools into larger education entities. The **Colorado League of Charter Schools** is researching this strategy.[xx] Essentially, the idea calls for investors to make funds available to the administering body such as a charter school resource center instead of the individual schools. The schools under the blanket of the administering body then withdraw portions of the funds provided by investors. Those schools that participate can reduce the cost of financing by dividing up any financing fees among them. Spreading loan payments among multiple schools lowers the risk charter schools pose since the probability of multiple charter schools failing or defaulting is smaller that just one. With the lower risk, more investors might be willing to provide funds to the administering body, especially if charter schools flourish.[xxi]

4. Attracting Private Investment

To attract private investment dollars to charter schools, states need to increase incentives for investors and obviate any investor apprehension. As with landlords, states can offer tax credits to investors as an incentive to invest in charter schools. Reduced tax burdens for investors mean more favorable financing rates for charter schools. The federal and state governments commonly use this method to encourage investments in the renovations of historical buildings. Such an approach can reduce the project costs up to 40 percent. Indeed, such benefits can make investing in charter schools more attractive.

- One model tax credit program is the federal **Qualified Zone Academy Bonds**. This program provides a federal income tax credit to lenders who invest in schools that are located in either an "empowerment zone" or in an "enterprise community," or that serve low-income students. States could mimic this tax credit to drive down the cost of financing charter schools.

  Tax credits provide extra incentives for investors, but states will need to do more to increase investor confidence. The risks that charter schools potentially pose to investors are most likely the largest roadblock to adequate access to private funding. Like with any business venture, there are a variety of financing options available to charter schools, but selling a new idea to investors can be difficult. Policy makers must consider ways to improve the charter school's operating environment in order to improve the security of the investment and the confidence of the investors.[2]

- A simple solution is to have states, cities or the federal government guarantee loans to charter schools. By providing the schools with the full faith and credit of the government, investors will regard charter schools as a stable business proposition and be more willing to offer them access to financing.

- Lengthening the period of charter school validity will also help investors warm up to charter schools. Most states set the initial renewal term of the charter up to five years, but some states are expanding that period. In practice, however, a charter has to demonstrate its credibility every year to remain open and enrolled.

  Political obstacles can be a major impediment for charter schools. The degree of the barrier varies from state to state and community to community depending on the area's understanding if charter schools.[3] Protecting charter schools from the politics of revocation and non-renewal is another way to provide stability. The state should advocate clear standards for revocation and create a process to appeal the revocation to protect schools from arbitrary non-renewal. This will assure investors that a school will be not closed down without good cause.[xxii]

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These are only a few of the more popular avenues for policy change that can make it easier for charter schools to gain access to much needed capital financing. These ideas can create a fertile environment in which new charter schools can grow and prosper.

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[2] For more information on the growing education industry see www.EduVentures.com and www.edindustry.com.
[3] For more information on the obstacles charter school often face see *Charter Schools Today: Changing the Face of American Education* (Washington, D.C.: The Center for Education Reform, 2000), pp. 27-59.

For more information on charter school financing, please refer to: the Charter Friends Network "*Paying for the Charter Schoolhouse*" February, 1999 (visit their website at www.charterfriends.org) ; and the Center for Market-Based Education "*School Facilities: Charter School Case Studies*" May 23, 2000 (their website is www.cmbe.org).

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The Center for Education Reform is a national, independent, non-profit advocacy organization founded in 1993 to provide support and guidance to individuals, community and civic groups, policymakers and others who are working to bring fundamental reforms to their schools. For further information, please call (202) 822-9000 or visit our website at www.edreform.com.

Endnotes:

[i] See A.R.S. 15-188 or R7-2-316 for more details regarding this Stimulus Fund..

[ii] For more details regarding financing in Minnesota's revised charter law see S.F. No. 706 sections 1, 8 and 9 in the Minnesota State Senate or the Omnibus Bill (HF 2333).

[iii] Details regarding the Massachusetts grant program can be found in Chapter 69 of Massachusetts' General Laws, section 1M and Chapter 71 section 89.

[iv] For more information see Florida House Bill 2087 at <www.leg.state/fl.us/session/2000/House/bills/billtext/html/billtext/hb2087e2.html> or visit the Florida Charter School Resource Center at <http://ari.coedu.usf.edu/fcsrc/>. For information on the amount that the state allocates for capital funding, see FL ST § 235.435 (6) (B), funds for comprehensive educational plant needs; construction cost maximums for school.

[v] Florida's Charter law section 228.0561 provides more information regarding capital outlay funding and Section 235.216(2) contains details regarding Florida's School Infrastructure Thrift (SIT) Awards.

[vi] Utah code section 53A-1a-513 section 3 contains the authorization for these start-up grants.

[vii] For example, New York's 1998 charter school law 7881, § 2853 defines the charter entity to be a public agent.

[viii] Russell Caldwell Bigelow and Company and Barry Arrington and Rouse, P.C., *Colorado Charter Schools Capital Finance Study: Challenges and Opportunities for the Future* (Denver: Prepared for the Colorado Department of Education, January 2000), p. 38.

[ix] The Arizona legislature passed House Bill 2103 in June 1999.

[x] Michael B. Marois, "Arizona's Pooled Deal For Schools," *The Bond Buyer*, Vol. 331, No. 30841, Friday, March 3, 2000.

[xi] Id. For more information on Standard and Poor's school evaluation services visit <www.standardandpoors.com/school>

[xii] Russell Caldwell Bigelow and Company and Barry Arrington and Rouse, P.C., *Colorado Charter Schools Capital Finance Study: Challenges and Opportunities for the Future* (Denver: Prepared for the Colorado Department of Education, January 2000), p. 37.

[xiii] For more information see Florida House Bill 2087 at <www.leg.state/fl.us/session/2000/House/bills/billtext/html/billtext/hb2087e2.html> or visit the Florida Charter School Resource Center at <http://ari.coedu.usf.edu/fcsrc/>.

[xiv] For more information see http://www.prudential.com/aboutpru/community/corporate/learn/cmclz1002.htm

[xv] For more information see www.epenergy.com/about/involve.htm, visited September 25, 1999.

[xvi] For more information see http://www.ncb.com/comm_dev.htm, visited September 23, 1999.

[xvii] For more information see http://www.self-help.org/, visited October 1, 1999.

[xviii] For more information see http://npo.net/nponet/alerts/iff.html, visited October 1, 1999.

[xix] For more information on the California Revolving Loan Fund see <www.cde.ca.gov/charter/funding/revloan2.html>, visited March 29, 2000.

[xx] For more information see http://www.coloradoleague.org/, visited October 1, 1999.

[xxi] Russell Caldwell Bigelow and Company and Barry Arrington and Rouse, P.C., *Colorado Charter Schools Capital Finance Study: Challenges and Opportunities for the Future* (Denver: Prepared for the Colorado Department of Education, January 2000), p. 39.

[xxii] See also Russell Caldwell Bigelow and Company and Barry Arrington and Rouse, P.C., *Colorado Charter Schools Capital Finance Study: Challenges and Opportunities for the Future* (Denver: Prepared for the Colorado Department of Education, January 2000), p. 37.

CSDC Fact Sheet

- CSDC is a financial services company (incorporated as a non-profit, tax-exempt organization in the District of Columbia) formed to provide credit enhancement products and services that support facilities financing for public charter schools.

- "Credit enhancement" is defined as leveraging private capital (debt financing) by using a reserve fund to offset any losses incurred by private providers of financing to many charter schools.

- In FY 1999, CSDC received a federal grant through the US Department of Housing and Urban Development's Community Development Block Grant program to begin operations. The $750,000 congressional appropriation is available "for working capital and design of a credit enhancement program required to leverage private financing for school facilities using the District of Columbia as a model for a national approach."

- In June 2000, the Charter Friends National Network called for federal funding for multi-state demonstration projects that provide credit enhancement for charter schools to help charter schools address the facilities financing challenge (Charter Friends National Network Federal Policy Update, June 29, 2000).

CSDC Programs and Services

1. Loan guarantee (credit enhancement)

- Assist public charter schools in obtaining conventional or unconventional facilities financing at favorable interest rates and guarantee loan if necessary.
  >provide additional security/collateral (using letter of credit from highly rated, widely recognized lending institution serving as a depository for CSDC funds)

- CSDC could act as "lender of last resort"
  >more for short term borrowing and working capital needs

2. Purchase property (school facility), build-to-suit or renovate as necessary, and lease to public charter school tenant(s)

- Operate/mange property as part of CSDC's portfolio of properties

- Consider fee ownership when lending institutions require First Trust Deed as security and are unwilling to lend directly to public charter schools.
  >note: some lending institutions may prefer to deal with CSDC (and its state/local affiliates) as an intermediary to avoid the possibility of foreclosing on a public charter school

- build equity fund to satisfy down payment/equity requirement in those instances when CSDC and its lending partners are unable to finance 100% of the cost of acquiring and renovating properties for lease and use by public charter schools.
  >REIT or national syndication
  >form equity partnership (investors) on a property by property basis

- CSDC acts as "developer" to bring together investor (equity partner), bank (lending partner) and public charter school (tenant).

- Public charter school could exercise "option to purchase" pursuant to agreement between CSDC (or its affiliate) and public charter school.
  >percentage of lease payments could apply to purchase price (down payment)

Trademarked Products

1. KinderKash™

   >"bridge loan" or short term financing program for operating purposes (working capital)
   >CSDC loans funds directly or provides loan guaranty

2. KinderKapital™

   >facilities financing
   >CSDC provides loan guaranty and/or credit enhancement facility
   >CSDC acts as landlord (property owner) or lender of last resort

3. KinderMae™

   >secondary market maker for the "pooled financing" of public charter schools
   >acts as intermediary for the purchase (from lending institution) and resell (to investors) of loans secured or "backed" by mortgages on public charter schools

Non-Profit

CHARTER SCHOOLS DEVELOPMENT CORPORATION

Devoted to Educational Excellence and Governance Reform

RICHARD E. THOMPSON
President

1725 K St., N.W., Suite 700 • Washington, DC 20006 • (202) 739-9629

Charter Schools Facilities Financing Demonstration Program.

Legislative Outline

Of the amount appropriated for school construction and renovation activities, the Secretary shall reserve for each fiscal year the greater of 10 percent or $100,000,000 to carry out a Charter Schools Facilities Financing Demonstration Program.

Purpose. It is the purpose of this Program to provide grants to one or more qualified non-profit corporations to undertake innovative credit enhancement initiatives to assist charter schools to address the cost of acquiring, constructing, and renovating facilities.

In General. The Secretary, acting through the Office of Charter Schools, shall award grants to one or more eligible entities having applications approved pursuant to this Program to demonstrate innovative methods of assisting charter schools to address the cost of acquiring, constructing, and renovating facilities by enhancing the availability of loans or bond financing.

Award Criteria. In making awards under this Program, the Secretary shall consider only applications from private, not-for-profit corporations. The Secretary shall give preference to entities that have as their mission the provision of facilities and other financing assistance to public charter schools, those that have a history and proven record of providing such services, and those that have previously been funded by the federal government to design and implement a credit enhancement program to leverage private financing for charter schools facilities using the District of Columbia as a model for a national approach. The Secretary shall also give preference to applicants who have the capacity to operate a large, broad based, multi-state program.

Authorized Activities.

Grantees may use funds provided under this program to assist charter schools to accomplish one or more of the following objectives:

> The acquisition of interests in improved or unimproved real property (including by purchase, lease, or donation) necessary to commence or continue the operation of a charter school.
>
> The Construction of new improvements, or the renovation, repair or alteration of existing improvements (including the purchase or replacement of fixtures and equipment) necessary to commence or continue the operation of a charter school.

Planning, development and other costs incidental to the accomplishment of the foregoing objectives.

To assist charter schools to accomplish the foregoing objectives, grantees may undertake any one or more of the following credit enhancement activities to the extent that such activities are permitted by and consistent with applicable state or local laws:

- Activities intended to enhance the availability and affordability of loans (including mortgage loans) to charter schools, including by:
  - Guaranteeing all or a portion of such loans
  - Insuring such loans
  - Providing security for such loans, including by pledging collateral or taking title to real property.
  - Facilitating a secondary market for such loans.
  - Providing all or a portion of a required downpayment, subsidizing interest payments, or otherwise directly facilitating such loans.
  - Helping identify potential lending sources, encouraging private lending, and other similar activities to promote lending to charter schools.

- Activities intended to enhance the availability of bond financing for charter schools, including:
  - Facilitating the issuance of bonds by charter schools or by other public entities for the benefit of charter schools by:
    - Providing technical, administrative and other appropriate assistance (including recruitment of bond counsel, underwriters and potential investors; and helping to consolidate multiple charter school projects within a single bond issue).
    - Providing financial or other assistance necessary to improve the rating of a proposed bond issue, to improve the repayment terms for a charter school, to induce the participation of underwriters, or to otherwise enhance the commercial feasibility of a proposed

transaction (including by providing for repayment of all or a portion of installment payments on the bond amount in the event of borrower default, through the pledging of reserves or other collateral, or by agreeing to take or hold title to property or other interests).

Directly issuing bonds for the benefit of charter schools.

Prohibited Activities. Grantees may not use funds provided under this program to provide direct loans or grants to charter schools; Grantees may not use funds provided under this program to supporting the ordinary operating expenditures or acquisition of school materials.

Applications. Applicants shall submit such information in such form as the Secretary may reasonably require. Such information shall include a statement identifying the activities proposed to be undertaken and a statement explaining how those activities can be expected to leverage other sources of private capital and otherwise enhance credit available to charter schools.

Reports. Not later than two years after award, and every year thereafter, grantees shall submit a report to the Secretary on their activities and providing for an evaluation of the effectiveness of those efforts.

Definitions. The definition of "charter school" is that found at 20 USC Sec. 8066(1).

Clarifications. Grantees activities remain subject to state and local laws; Grantees do not obtain any powers of the federal government by virtue of their receipt of funds under this program (e.g. tort immunity, full faith and credit); Grantees may acquire interests in real property;

CHARTER SCHOOLS FACLITIES FINANCING DEMO PROGRAM

Background

- Charter schools are taxpayer funded public choice schools that operate independently of the local public school system. Charter schools are open to all comers on a cost-free, first come, first served basis. According to the Center for Education Reform, when school starts this fall more than 500,000 students will be attending over 2000 charter schools in 36 states and the District of Columbia that have adopted charter schools laws.

- Charter schools are where the right and the left of the political spectrum converge in support of school choice. From Republican Governors and Members of Congress to the President and the Presidential candidates of both political parties, there is a broad consensus in favor of Federal support of charter schools.

The Problem

- The biggest issue facing charter schools is financing school facilities. According to the Charter Friends National Network, "charter schools...have neither bonding nor taxing authority. Few states provide charter schools alternative sources of up-front capital for their facilities, and many make it difficult for charter schools to tap the tax-exempt bond markets that districts use to finance buildings. Only a handful of states provide any ongoing funds for buildings, requiring charter schools to pay capital expenses out of dollars meant for the classroom."

- Charter schools are forced to spend precious operating funds – intended to pay for teachers, books, computers, and other educational necessities – on their buildings. In addition, school leaders must spend an inordinate amount of time dealing with facilities issues instead of working to increase student achievement. Many promising charter schools never even open because of the challenges of finding a facility they can afford; and those that do open, often find themselves in buildings that are too small or inadequately configured for their educational programs. This problem is most acute in low-income communities that lack the resources and connections to solve the facilities financing problem.

- Unfortunately, specific assistance for charter schools to finance facilities is not included in the President's school construction proposal.

The Solution

- The Federal government has played a vital role in expanding the number of charter schools around the nation. It can continue to play a key supportive role – without impeding upon state and local control of charter schools – by helping obtain access to capital for charter school construction. This can be done is such a way as to create a tremendous leveraging effect that will make a relatively small amount of Federal support go along way.

- According to the Charter Friends National Network, one way for the Federal government to have an immediate impact on this problem is "to provide funding for state and multi-state efforts to open up charter schools' access to private capital. For example, state educational agencies or non-profit organizations could receive pools of funds to use as reserves against losses incurred by private providers of financing to many charter schools. The existence of such reserves would make finance providers more willing to work with charter schools, and to do so at lower rates of interests. By awarding funds to initiatives that promise innovative approaches, a high degree of leverage of private funding, and the possibility of replication in other states, Congress could serve as a catalyst for efforts to address this problem all over the country."

- Providing funds to states for charter schools financing may be one answer. However, not all states have --- or are likely to create any time soon – charter schools facilities programs. Charter schools in those states must find another way to seek facilities help.

- Congress can help charter schools throughout the nation by creating a national demonstration program that allows schools in all 50 states access to capital to help meet their facilities needs. Furthermore, by taking advantage of non-profit organizations already in existence with a proven track record of assisting charter schools with facilities issues, such a program could provide important immediate help. For example, in the District of Columbia, there is already a proven non-profit corporation that could be expanded to serve schools around the nation.

- Procedurally, Congress could accomplish this in a variety of ways. The existing charter schools law could be amended to provide for such a demonstration program. Or, if Congress decides to add funding for school construction in this year's Labor/HHS Appropriations bill, a small amount (10%) could be set aside for a charter school credit enhancement demonstration program. (See the attached for specific language)

- Charter schools are perhaps the single most important, wide-ranging reform in education today. For the charter school movement to continue to thrive, however, they must have access to capital to finance their facilities. Congress and the President can continue to express its support for the charter school movement by creating and funding this demonstration program that can leverage literally billions of dollars for charter schools facilities around the nation.

<u>WHY A *NATIONAL* DEMONSTRATION CHARTER SCHOOLS PROGRAM IS NECESSARY</u>

If Congress gives states the resources and authority to operate their own charter school facilities, why is a Federal program necessary? Here's why:

- **A national program can bring expertise and economies of scale that small statewide programs cannot match.** Many states simply do not have enough charter schools to make a statewide effort to improve and expand charter schools facilities worthwhile. A national program can marshal resources and expertise that few states will be able to match.

- **A national demonstration program can test new and innovative methods to fund charter schools**. A national program can be of the size and scope to allow for more flexibility and innovation than smaller, locally based programs.

- **A national demonstration program complements state efforts.** Some states may chose to run charter schools facilities programs on their own, and the legislation should allow them to do so. However, other states will refuse not to, and others may not be capable of doing so. A national demonstration program could serve charter schools in states without a charter schools program, or provide charter schools with an additional option for facilities funding in those states that have their own program.

- **In many States, there simply are not enough charter schools to make a statewide charter schools facilities program worthwhile.** For charter schools in these states, a national program may well be their only hope.

- **Many state education bureaucracies continue to oppose charter schools, and set up artificial barriers to program participation and funding.** While the charter school movement has made enormous progress throughout the country, it still has opponents – many of whom reside in state and local education agencies. A national program can serve as a competitive force to help spur states that are reluctant to support charter schools to action, as well as give local charter schools an alternative source of funding if they are unable to successfully navigate a hostile state education bureaucracy.