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U.S. DEPARTMENT OF EDUCATION

# Making Charter School Facilities More Affordable State-driven Policy Approaches

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INNOVATIONS IN EDUCATION

# Making Charter School Facilities More Affordable State-driven Policy Approaches

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I N N O V A T I O N S   I N   E D U C A T I O N

Prepared by WestEd

For

U.S. Department of Education  
Office of Innovation and Improvement

2008

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**U.S. Department of Education**

Margaret Spellings  
*Secretary*

**Office of Innovation and Improvement**

Amanda L. Farris  
*Assistant Deputy Secretary*

**Parental Options and Information**

Dean Kern  
*Director*

December 2008

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# Foreword

I am pleased to introduce *Making Charter School Facilities More Affordable: State-driven Policy Approaches*, the latest guide in the *Innovations in Education* series. This guide complements earlier charter-school-related guides in the series, one that examines high-quality charter authorizers and another that looks at charter schools that are closing achievement gaps by raising all students' academic performance.

Charter schools have demonstrated that—by design—they can be positioned to innovate and excel, utilizing unique organizational structures and new and promising instructional strategies. Free from many of the regulations that govern traditional public schools, charter schools exchange this flexibility for greater accountability for results. However, these schools often face difficult challenges that their traditional counterparts do not experience.

For example, charter schools frequently have to secure and pay for their facilities. Many of these schools must cover capital costs by diverting funds that were intended for instruction. The lack of dedicated facilities funding and the effort charter school leaders must expend to search for and maintain appropriate facilities can take away from teaching and learning. Anecdotal accounts suggest that, due to high facilities costs, a large number of qualified charter schools never even open their doors. Parents and communities who look to charter schools to provide promising choices for their children's education expect and deserve better.

This guide profiles policy interventions from eight states and the District of Columbia that have been developed to help charter schools address various facilities-related challenges. While this guide does not describe every effort, in the following pages you will learn how some jurisdictions have dedicated funding streams to support charter facilities and how others have helped charter school operators access relatively low-cost financing to lease, buy, or renovate their school buildings.

The *No Child Left Behind Act* recognizes the value of charter schools in our national effort to ensure that every child can read and do math on grade level by 2014. I hope policymakers and charter school advocates can learn from the examples provided here and help charter schools gain access to the resources that they and their students need to succeed.

Margaret Spellings, Secretary  
U.S. Department of Education





# Abbreviations

**ACSA** (Arizona Charter Schools Association)—a nonprofit organization that serves charter schools in Arizona and advocates for charter school quality, growth, and autonomy in the state

**CDE** (California Department of Education)—the state agency primarily responsible for overseeing public elementary and secondary schools in California

**CECFA** (Colorado Educational and Cultural Facilities Authority)—the Colorado finance authority, established by the Colorado General Assembly in 1981, that provides cultural and educational institutions in the state with low-cost capital financing for their projects through the sale of tax-exempt bonds

**CER** (Center for Education Reform)—a nonprofit corporation based in Washington, D.C., that advocates for school choice nationally

**CSFC** (Charter School Finance Corporation)—a nonprofit corporation, established through an amendment to the Texas *Education Code* in 2001, that issues bonds specifically for the acquisition, construction, repair, or renovation of facilities for open-enrollment charter schools in Texas

**CSFP** (Charter School Facilities Program)—a California-based program providing state funds for the construction or rehabilitation of charter school facilities

**DCPS** (District of Columbia Public Schools)—the public school district for Washington, D.C.

**FOCUS** (Friends of Choice in Urban Schools)—a nonprofit organization that serves charter schools in Washington, D.C., and advocates for charter school quality, growth, and autonomy in the District of Columbia

**IRS** (Internal Revenue Service)—the federal agency responsible for the collection and enforcement of taxes

**KIPP** (Knowledge Is Power Program)—founded in 1994, a national network of free, open-enrollment college preparatory public schools in underserved communities

**LISC** (Local Initiatives Support Corporation)—a national nonprofit organization that combines corporate, government, and philanthropic resources to help community-based organizations revitalize underserved neighborhoods

**MassDevelopment** (Massachusetts Development Finance Agency)—the Massachusetts finance and development authority, legislated into existence in 1998 for the purpose of providing businesses and local officials in distressed communities with financial and real estate tools and expertise to stimulate economic growth in the state

**MDE** (Minnesota Department of Education)—the state agency primarily responsible for overseeing public elementary and secondary schools in Minnesota

**MPEFA** (Michigan Public Educational Facilities Authority)—the Michigan finance authority



that provides low-cost financing and technical assistance for qualified public education facilities and charter schools (known in the state as public school academies) through its bonding and loan programs

**NHCS** (Neighborhood House Charter School)—a public charter school in Boston serving students in pre-Kindergarten through grade 8

**NMCCS** (New Mexico Coalition for Charter Schools)—a nonprofit organization that serves charter schools in New Mexico and advocates for charter school quality, growth, and autonomy in the state

**ODMPED** (Office of the Deputy Mayor for Planning and Economic Development)—a Washington, D.C., office that supports the mayor in developing and executing the District of Columbia's economic development policy

**QZAB** (Qualified Zone Academy Bond)—a debt instrument created by the U.S. Congress in 1997 to help eligible schools raise funds to renovate and repair buildings, invest in equipment and up-to-date technology, develop challenging curricula, and train quality teachers

**RUSD** (Rocklin Unified School District)—the public school district for Rocklin, Calif.

**TAM** (technical advice memorandum)—guidance furnished by the Office of Chief Counsel of the IRS, providing interpretation of proper application of tax laws, tax treaties, regulations, revenue rulings, or other precedents

**TCEP** (Texas Credit Enhancement Program)—a debt-service reserve fund, operated by the Texas Public Finance Authority Charter School Finance Corporation in consortium with the Texas Education Agency and the Resource Center for Charter Schools, that guarantees eligible tax-exempt bonds issued on behalf of Texas charter schools for their facilities

**TEA** (Texas Education Agency)—the state agency primarily responsible for overseeing public elementary and secondary schools in Texas

**TPFA** (Texas Public Finance Authority)—the Texas agency that since 1984 has provided capital financing for state agencies and certain public institutions of higher education



# Acknowledgments

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An external advisory group provided feedback to refine the scope of the study underlying this guide, define the criteria for selecting case study states, and clarify the text. Members (and their affiliations at the time of the advisory meeting) were Elise Balboni, vice president, Education Programs, Local Initiatives Support Corporation; Annie Donovan, chief operating officer, NCB Capital Impact; Bryan Hassel, co-director, Public Impact; Barbara Page, independent consultant; and Todd Ziebarth, state policy director, National Alliance for Public Charter Schools.

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The information in this guide is based in large part on interviews with 35 individuals from eight states and Washington, D.C., all of whom were generous with both time and attention. This guide could not have been developed without their thoughtful involvement. These respondents were Carole Barkley, Robert Cane, Norman Chaffee, Jug Chokshi, Cliff Chuang, Andy DeYoung, Michele Diamond, Bill Dougherty, Kim Edwards, Shannon Farrell-Hart, Sam Gaillard, Gary Geeting, Jim Griffin, Lisa Grover, Katie Howell, Stefan Huh, Katrina Johantgen, Clare Jozwiak, Barbara Kampmeiner, Jay Kaprosy, Joe Keeney, Marc Kenen, William A. Liggins, Adam Miller, Kathleen O’Keefe, David Patterson, Mary Perry, Judith Porras, Dan Quisenberry, Steven Race, Jon Schroeder, Eileen Sigmund, Jo Ann Soker, Rebecca Sullivan, and Caprice Young. For the state and professional affiliation of each interviewee, see table A1, “Respondents Interviewed for This Guide” in appendix A, Research Methodology.

The cover photograph is of MATCH Charter Public School, a Boston-based college preparatory middle and high school. MATCH is housed in a 1918 building originally designed as the New England headquarters for Lincoln Automobiles. Although the building has been upgraded to better serve its current purpose, a palatial center stairway and a high-ceilinged hall with neo-Egyptian columns that once served as the automobile showroom attest to its automotive-related origins.





# Introduction

*Securing appropriate facilities can be a daunting challenge for those intending to open a charter school. Although, like all public schools, charter schools receive per-pupil dollars from the state, they generally receive considerably less—on average, only 78 cents for every dollar in state aid given to their traditional counterparts, according to one study.<sup>1</sup> More to the point, however, because traditional public schools rely on their district to provide their school facilities, they can spend 100 percent of their per-pupil operational funding on their instructional program, whereas most charter schools have to stretch those dollars to cover facilities costs as well.*

Some districts receive direct funding from the state for their capital expenses, such as school construction or improvements. Districts that do not receive this type of funding or that need additional capital can issue voter-approved general obligation bonds, which are secured by taxes. This is one of the most inexpensive forms of financing and one to which charter schools have had virtually no access because almost no states or local jurisdictions have granted charter schools direct access to local tax revenue. Instead, when looking for capital funds, charter school operators have had to turn to the private sector where, if financing is available, it comes at a significantly higher cost.

Anecdotal accounts suggest that many qualified charter schools never open because they cannot afford facilities.<sup>2</sup> And of the 4,300<sup>3</sup> charter schools that are already open, almost all have had little choice but to divert some portion of their state operating revenue to cover the expenses of buying or leasing, and in some cases improving, their buildings. Naturally, this leaves them with less money for what counts most—instruction.<sup>4</sup>

Across the country, state legislators and charter school advocates alike have been seeking

innovative strategies to help charter schools keep more of their instructional dollars in the classroom, while, at the same time, giving their students a safe, suitable place in which to learn each day. This guide showcases charter school facility laws and practices that have been developed to tackle the facilities challenge in eight states and Washington, D.C. With few exceptions, these “solutions” do not solve the problem entirely, but all of them are intended to mitigate the facilities barriers charter schools face, and, as such, perhaps can provide some heretofore underutilized models.

## Affordable Facilities: Key to Charter School Expansion

Charter schools entered the mix as part of the U.S. public education system in the early 1990s. These schools were established on the premise that they would enter into contracts (i.e., charters) detailing specific goals that they are accountable for achieving in exchange for independence from many of the laws and regulations that govern traditional public schools. This flexibility is intended to allow charter schools to educate

students in new and potentially more effective ways and, in doing so, to serve as incubators for innovative ideas that could be adopted more widely as part of the nation's efforts to reform and improve public education. Charter schools provide an academic alternative for students, increasing the public school choices for parents and opportunities for educators to create schools based on a particular mission and vision. According to the National Alliance for Public Charter Schools, there are currently more than 1 million students attending charter schools in 40 states and Washington, D.C.<sup>5</sup> However, this enrollment figure can mask the challenges associated with locating and paying for facilities—challenges that some consider to be a major barrier to the expansion of the charter school sector.<sup>6</sup>

The federal government has initiated several programs to stimulate private and state-level investment in charter school facilities. Specifically, two programs administered by the U.S. Department of Education's Office of Innovation and Improvement are designed to ease the facilities financing challenge by offering federal grant funds for charter school facilities: the State Charter School Facilities Incentive Grants program<sup>7</sup> and the Credit Enhancement for Charter School Facilities program.<sup>8</sup> The former program provides matching funds to states that offer per-pupil funding specifically for charter school facilities. The latter awards funds to public and nonprofit entities that help leverage other funds from the private sector for the purchase, construction, lease, or renovation of facilities by increasing the creditworthiness of charter schools. (An example of credit enhancement is when, in the home loan arena, a buyer who is able to provide only a small down payment purchases primary mortgage insurance to increase his or her creditworthiness with a mortgage lender.)

Four other federal programs also offer facilities-related support: The Public Assistance Grant Program operated by the Federal Emergency Management Agency offers grant assistance for the replacement or repair of disaster-damaged facilities of qualifying private, nonprofit organizations. The U.S. Department of Agriculture's Community Programs administers programs to finance and develop essential community facilities and services, including schools, in rural areas. The New Markets Tax Credit Program and the Qualified Zone Academy Bond Program, both operated by the U.S. Department of the Treasury, provide federal income tax credits for investing in qualified entities, which can include charter schools.<sup>9</sup>

## Forms of State-driven Facilities Assistance

Recognizing that federal support is not enough, a number of states and Washington, D.C., have taken their own steps to ensure charter school students have the opportunity to learn in safe and appropriate settings. Subsequent sections of this guide examine three primary, state-driven policy approaches to mitigating charter schools' facilities needs by easing operators' access to funding, affordable financing, or publicly financed space.

*Direct cash assistance for facilities.* Part I examines how some jurisdictions are providing a dedicated funding stream in the form of a per-pupil allocation or other grant program funds specifically directed to support charter school facilities.

*Ability to borrow money for facilities.* Part II looks at the various ways in which jurisdictions are helping charter school operators obtain affordable capital to buy, lease, or upgrade their facilities. These methods include giving

operators easier access to tax-exempt or interest-free bond financing, setting up special low-cost loan programs, and providing credit enhancement opportunities for charter schools.<sup>10</sup>

*District provision of facilities.* Part III explores what some jurisdictions are doing to encourage or mandate districts to provide charter schools with facilities. These strategies range from providing facilities at no cost to providing them at a market rate.

Currently, 17 of the nation's 41 charter laws have authorized per-pupil or other grant funding programs for charter school facilities.<sup>11</sup> Many of the jurisdictions with charter laws enhance the borrowing capacity of these schools by allowing them to access tax-exempt debt markets or offering credit enhancement.<sup>12</sup> Yet very few states authorize or encourage districts to provide charter schools with facilities directly.<sup>13</sup> This publication features examples of how these various types of support are being implemented in eight states and Washington, D.C. The guide does not describe every facilities support effort in each jurisdiction; rather, it focuses on those that are most intensive and most effectively implemented, as determined by the researchers with guidance from project advisors (see appendix A for additional details about the site selection process). Table 1 shows the facility financing assistance programs and policies featured in this guide, by form of assistance and charter school jurisdiction.

## Process for Selecting Exemplar Policies and Implementation Sites

Because there is relatively little research about what constitutes exemplary policy for addressing

charter school facilities financing issues, the selection process for this guide was challenging. As further described in appendix A, Research Methodology, the research team relied extensively on guidance from a five-member advisory group comprising charter school experts familiar with facilities issues and charter school facility finance experts. Based on an examination of the research and on advisor recommendations, the team developed a study scope and criteria for the selection of study sites that were reviewed by the advisors and further refined with their input.

The information included in this guide has been drawn primarily from phone interviews with 31 respondents across nine featured sites. A wide range of individuals were interviewed, including staff of state charter school associations and resource centers, staff of public entities issuing bonds on behalf of charter schools, financial experts within state agencies administering charter school programs, and staff working in charter offices within state departments of education. In addition, researchers contacted a small number of charter school operators that state respondents suggested based on school operators' understanding of and experience with the various forms of facilities assistance described in the guide. Three of these schools are profiled to illustrate how the state policies and programs described can effectively function in practice. For a list of those interviewed and their affiliations, see the methodology in appendix A. The research team also requested that respondents, when possible, send the state statutes that established the forms of assistance profiled. The URLs for the relevant Web sites where these statutes are available online are listed in appendix A.

**Table 1.** Summary of Highlighted Jurisdictions by Year of Charter Law Enactment, Number of Charter Schools, and Featured Facilities Assistance Categories<sup>a</sup>

Jurisdiction	Year Charter Law Enacted <sup>b</sup>	Number of Charter Schools <sup>c</sup>	Categories of Facility Assistance		
			Direct Cash Assistance <sup>d</sup>	Ability to Borrow <sup>e</sup>	Provision of Facilities <sup>f</sup>
Arizona	1994	455	X		
California	1992	692		X	X
Colorado	1993	141		X	X
Massachusetts	1993	61	X	X	
Michigan	1993	230		X	
Minnesota	1991	143	X		
New Mexico	1993	69	X		
Texas	1995	434		X	
Washington, D.C.	1996	81	X	X	X

<sup>a</sup> This table identifies sites whose efforts in one or more of three general facilities assistance categories (note last three columns) are profiled in this guide. The absence of an X in a particular category of assistance does not necessarily mean the site does not offer this type of assistance; it may simply mean that the site's activity in this area is not profiled in this guide (see appendix A, Research Methodology, for selection considerations). For instance, California and Colorado both offer direct cash assistance to charter schools, but at substantially lower levels than those of the profiled jurisdictions (see table 2).

<sup>b</sup> Information from the National Alliance for Public Charter Schools Web site at <http://www.publiccharters.org/states>.

<sup>c</sup> Ibid.

<sup>d</sup> The “direct cash assistance” category refers to state-level provision of a dedicated funding stream in the form of a per-pupil allocation or other grant program funds specifically directed to support charter school facilities.

<sup>e</sup> The “ability to borrow” category refers to the various ways in which jurisdictions are helping charter school operators obtain affordable capital to buy, lease, or upgrade their facilities. These methods include giving operators easier access to tax-exempt or interest-free bond financing, setting up special low-cost loan programs, and providing credit enhancement opportunities for charter schools.

<sup>f</sup> The “provision of facilities” category refers to policies that encourage or mandate districts to provide charter schools with facilities. These strategies range from providing facilities at no cost to providing them at a market rate.

This guide is not based on experimental research that can make causal claims about what policies and practices are most effective. Readers should judge for themselves the merits of the policies and practices profiled in the guide and reflect on why and how well the forms of assistance would work in their specific contexts. These descriptions neither constitute an endorsement

of specific policies or practices nor make the claim that the policies and practices described in the guide are perfectly implemented. However, policymakers may be able to draw from the examples included in this guide to design facilities assistance policies that can best serve the needs of charter schools in their jurisdictions.



## PART I

# Direct Cash Assistance For Facilities

*In most instances, public schools receive state education revenue on a per-pupil basis. Because the average public school does not have to procure or improve its own facility—something that is taken care of by its district—per-pupil allocation formulas to individual schools historically have not accounted for capital expenses. Rather, this funding generally has been intended to support a school’s instructional program. But charter schools, which typically have to secure their own space, often have had little choice but to tap into those instructional dollars to cover facility costs.<sup>14</sup> Compounding this financial squeeze, charter schools usually receive fewer per-pupil dollars to start with, generally receiving a fixed percentage of the per-pupil allocation designated for their traditional peers. Some states grant charter schools less than half the per-pupil dollars that are given to regular public schools.<sup>15</sup>*

To help address the charter school facilities dilemma, policymakers in some states have created a dedicated funding stream to offset the capital or lease expenses of these schools. Typically granted in the form of a separate per-pupil allocation, this funding supplements any instructional revenue given by the state and is provided without any obligation of repayment.

### Allocation Models for Per-pupil Funding

As shown in table 2 on p. 6, direct cash assistance to mitigate facilities costs is available in 10 states, plus Washington, D.C. This section features the funding models in five jurisdictions that provide a minimum of (or an average of at least) \$700

per student in facilities funding. Although each of the five sites offers relatively high per-pupil facilities aid, collectively, their funding models vary. In discussing these models, the section also introduces two key issues that policymakers may want to consider when developing their facilities-aid formulas: 1) if and how to keep funding levels current with changing enrollment and facilities-related costs and 2) how flexible or restrictive the funding should be.

### *Adjusting for Changing Enrollment and Facilities-related Costs*

A number of the funding models discussed here, though not all, were developed with the intent of ensuring that the level of facilities-related



**Table 2.** Most Recently Available Per-pupil Facilities Aid Information for All Jurisdictions Offering Such Assistance

Jurisdiction	Per-pupil Facilities Aid <sup>a</sup>	Year Facilities Aid Started <sup>b</sup>	Usable for Non-capital Costs <sup>c</sup>
Arizona	\$1,445 (elementary and middle school) and \$1,684 (high school) <sup>g</sup>	1994	Y
California	Up to \$750 if state budget allows <sup>h</sup> (in FY 07, average was \$283)	2001	N
Colorado	\$292	1994	N
Florida	\$374 (elementary school), \$429 (middle school), and \$567 (high school) <sup>i</sup>	1998	N
Hawaii	\$686 <sup>l</sup>		N
Massachusetts	\$849	2005	Y
Minnesota	\$1,200 maximum <sup>n</sup>		N
New Mexico	\$700 on average <sup>o</sup>	2004	N
Pennsylvania	\$160 (elementary school), \$220 (high school), \$270 (vocational and technical schools) <sup>p</sup>	2001	N
Utah		2003	N
Washington, D.C.	\$3,109	1998	Y

**Note:** Data reported in this table are from multiple school years (i.e., 2006, 2007, 2008), since no single-year data source exists for the information included in this table. The school or fiscal year is included in the individual citations for the data reported in this table. Blank cells indicate no data were found.

**Sources:** This table includes data from multiple sources. The primary source is the *2007 Charter School Facility Finance Landscape* study published by the Local Initiatives Support Corporation (LISC). In cases where data were not available from this LISC report, other extant sources were sought or data were collected directly by the research team through interviews conducted in spring 2008 with charter association staff and state education agency staff. All data in the table are labeled with their source.

<sup>a</sup> Unless otherwise indicated, data in this column are for school year 2007–08 and are drawn from interviews conducted in spring 2008 with charter association staff and state education agency staff in each state.

<sup>b</sup> Dates in this column are drawn from LISC's *2007 Charter School Facility Finance Landscape* report, except in the case of Massachusetts, whose data were provided in July 2008 by a phone interview respondent.

<sup>c</sup> Data in this column are drawn from LISC's *2007 Charter School Facility Finance Landscape* report, as well as from phone interviews conducted for this guide.

<sup>d</sup> Data in this column are drawn from LISC's *2007 Charter School Facility Finance Landscape* report.

<sup>e</sup> Percentages and dollar amounts in this column were found on the Center for Education Reform (CER) Web site: [http://www.edreform.com/charter\\_schools/funding/chart.htm](http://www.edreform.com/charter_schools/funding/chart.htm). The CER data were drawn from fiscal year 2005–06 data on public education finances reported by the U.S. Census Bureau, a 2006 survey of charter schools conducted by CER, and data collected by CER from contacts at state departments of education, charter school associations, and Aspire Consulting. See the Web link listed above for full information on the sources for CER's chart.

<sup>f</sup> Data in this column are the sums of the per-pupil amounts in column 2 and the operating revenue amounts in column 6.

<sup>g</sup> See [http://www.arizonaaea.org/pdfs/politics/briefings/State\\_Aid\\_8.29.07.pdf](http://www.arizonaaea.org/pdfs/politics/briefings/State_Aid_8.29.07.pdf) for more information. This is the full amount of the state's "additional assistance."

<sup>h</sup> Charter schools in which at least 70 percent of the enrollment is eligible for free or reduced-price lunch can receive up to \$750 per pupil for up to 75 percent of their total lease costs reimbursed. This grant program has never been fully funded.

Usable for Purchase, Including Loan Payments <sup>d</sup>	Per-pupil Operating Revenue (in \$ and as a percentage of per-student funding for traditional public schools) <sup>e</sup>	Operating Revenue Plus Facilities Aid <sup>f</sup>
Y	\$6,075 / 76%	\$7,462 (elementary and middle school) and \$7,692 (high school)
N	\$7,034 / 69%	\$7,784
Y <sup>l</sup>	\$6,500 / 70%	\$6,700
Y <sup>k</sup>	\$6,552 / 69%	\$6,926 (elementary school), \$6,981 (middle school), and \$7,119 (high school)
Y <sup>m</sup>	\$8,000 / 54%	\$8,686
Y	\$10,107 / 68%	\$10,918
N	\$10,302 / 94%	\$11,502 (for schools opened in 2003–present) and \$11,802 (for earlier schools)
N	\$8,000 / 85%	\$8,600
N <sup>q</sup>	\$7,802 / 60%	\$7,962 (elementary school), \$8,022 (high school), \$8,072 (vocational and technical schools)
Y <sup>r</sup>	\$4,907 / 72%	
Y	\$11,154 / 61%	\$14,263

<sup>l</sup> Eligible uses include the construction, demolition, remodeling, financing, and purchase or lease of land, buildings, or facilities for charter schools.

<sup>k</sup> Data in this column are for fiscal year 2005–06, drawn from LISC's 2007 *Charter School Facility Finance Landscape* study.

<sup>k</sup> Funds can be used for the purchase of property; construction; purchase, lease-purchase, or lease of permanent or relocatable facilities; purchase of vehicles for student transportation; and renovation, repair, and/or maintenance of facilities that the school owns or is purchasing through a lease-purchase or long-term lease of 5+ years.

<sup>l</sup> Data in this column are for fiscal year 2006–07, drawn from LISC's 2007 *Charter School Facility Finance Landscape* study.

<sup>m</sup> Funds can be used for lease, rent, and/or building improvements; utilities, emergency generators, maintenance or minor facility repairs; major renovations or improvements that add to the useful life of the facility; and improvements that add capacity to the school's infrastructure for the purpose of improving a virtual education program.

<sup>n</sup> Approved charters are granted 90 percent of lease costs up to a maximum of \$1,200 per pupil.

<sup>o</sup> Schools are granted varying amounts in accordance with adjustments based on their facility's square footage.

<sup>p</sup> These amounts, reported in LISC's 2007 *Charter School Facility Finance Landscape* study, were legislated in 2001 through an amendment to the *Pennsylvania Public School Code*.

<sup>q</sup> Lease or rental costs for land, trailers, or modules are not eligible for reimbursement.

<sup>r</sup> Funds may be used for the purchase, construction, renovation or lease of a facility; leasehold improvements; debt service; or land acquisition.

aid appropriations keeps pace with changes in student enrollment, in facilities-related costs, or both. Of the five sites featured in this section, Washington, D.C., (the District) ties funding levels most tightly to these variables, while New Mexico's formula seems to have the loosest connection.

*Washington, D.C.* The District has offered a per-pupil funding program for charter school facilities, the Facilities Allowance for Public Charter Schools (Facilities Allowance), since 1998 and, at \$3,109 per pupil as of fiscal year 2007–08, it provides the nation's highest level of funding for charter school facilities aid. The formula for calculating its annual appropriation is designed to adjust the total funding available annually based on changes in capital costs and in the number of charter school students. It is based on a five-year rolling average of capital expenditures for the District of Columbia Public Schools (DCPS). The District's funding model is intended to ensure that charter schools can count on a relatively stable per-pupil revenue stream from year to year and that their funding is equitable to the amount spent on facilities for other DCPS schools.

Stefan Huh, director of the Office of Public Charter School Financing and Support in the Office of the State Superintendent of Education in Washington, D.C., says that without the Facilities Allowance, many charter schools in Washington, D.C., would be unable to open. He calls this aid the “cornerstone” that has “enabled schools to leverage financing on a long-term basis and to exercise some autonomy, choice, and discretion in how they go about securing sites.” But Robert Cane, executive director of

Friends of Choice in Urban Schools (FOCUS), reports that there has been discussion in the District about decoupling the facilities aid from the DCPS capital budget, in which case a new formula for the Facilities Allowance would be negotiated. If so, Cane says, the new formula should “be as close as possible to what we have now,” providing the maximum amount of flexibility for individual charter schools to use the money to meet their needs, and also including incentives for schools to be efficient in their use of money. However, Cane identified one drawback to the current method for calculating the per-pupil charter school facilities grant each year. Specifically, because the formula is based on a five-year rolling average of DCPS capital expenditures, charter schools that secured facilities many years ago may not need the entire allowance, whereas those with recent or upcoming major construction may need more.

*Massachusetts.* Similar to the District's approach, state law in Massachusetts requires that the per-pupil facilities allocation to charter schools be determined annually. Its formula is based on the statewide per-pupil average expenditure that districts paid in debt service during the most recent year that these expenditures were reported. Debt service includes payments of principal plus interest on bonded debt for capital costs associated with school construction, renovation, purchase, acquisition, or improvements. However, Cliff Chuang, coordinator of Charter School Research and Finance at the Massachusetts Department of Elementary and Secondary Education, explains that since 2006, the second year of this program, the state legislature has overridden the statutory formula. In the course of reorganizing its funding program for all public school facilities, the state

found that large, one-time payments to pay off existing local debt caused an unexpected spike in the calculated per-pupil facilities figure. In response, the legislature allocated a flat amount for charter school facilities aid (based on the previous year's figure plus an inflation factor) within the annual state budget appropriation, a practice that has continued. Although the amount of aid has risen each year by the inflation factor, the actual funding received by the charter schools has been lower than what would have been provided had the statutory calculation been used. Chuang says that, as of early summer 2008, preliminary calculations suggested that under the legislated per-pupil facilities-aid formula, the per-pupil grant for 2007–08 would have been about \$1,350, whereas the actual grant was \$849 per pupil. All Commonwealth charter schools in the state receive this support.<sup>16</sup>

Despite any discrepancies between the actual per-student facilities grants and those that might have been available under the statutory formula, Marc Kenen, executive director of the Massachusetts Charter Public School Association, says, “We feel lucky with what we have.” Now that the per-pupil allocation has reached what he sees as a minimum threshold, it has been crucial to charter schools’ overall success in securing facilities in the state, he says. Moreover, Kenen adds, as important as the actual amount of funding the program provides is the fact that by giving charter schools “a set guaranteed revenue stream that they can earmark for debt service, [the program] allows them to borrow.”

*Arizona.* In Arizona, the state’s per-pupil base support formula is calculated similarly for

traditional public schools and charter schools, according to Jay Kaprosy, former legislative liaison for the Arizona Department of Education and currently a government relations consultant for the Arizona Charter Schools Association (ACSA). But on top of the base support, Arizona charter schools receive additional assistance, which Kaprosy describes as a statutorily defined per-pupil amount. This means that as the number of charter school students increases, so, too, does the overall state budget allocation for the additional assistance.

Arizona’s per-pupil additional assistance funding for charter schools is differentiated by grade level because of the higher costs associated with secondary school facilities.<sup>17</sup> In fiscal year 2008, for example, charter schools received \$1,445 for each student in grades kindergarten through 8 and \$1,684 for each student at the high school level for facilities.<sup>18</sup> Yet because the assistance has not kept pace with rising construction costs, existing charter schools are falling behind and others cannot open, asserts ACSA chief executive officer Eileen Sigmund. She estimates that a third to a half of the 25 schools authorized in 2008 were unable to open. Noting that operators point to facility costs as the impediment, Sigmund says, “They simply cannot have a break-even school based on the amount of [facilities funding] available.”

*Minnesota.* Minnesota’s facilities aid currently provides charter schools 90 percent of their lease costs, up to a maximum of \$1,200 per pupil. The requirement that charter schools contribute a share of their lease payments (i.e., the other 10 percent) is intended as an incentive to encourage them to look for reasonably priced facilities. When the state legislature

enacted the per-pupil Building Lease Aid program in 1996, the cap was \$1,500 per student, but it was reduced subsequently to the current level.<sup>19</sup> According to an independent consultant on charter school facilities issues, Norman Chaffee, who formerly worked for both the Minnesota Department of Education (MDE) and the Minnesota Association of Charter Schools, this reduction resulted, in part, from a state budget crisis and from complaints from traditional public schools that the cap was too high. Chaffee says that, at around the time of the reduction, an MDE study found the debt service of all public institutions to be about \$850 per pupil, significantly lower than the \$1,500 per pupil that charter schools were receiving. To close the gap between the lease aid and debt service, a compromise was reached whereby charter schools that established leases under the \$1,500 per-pupil cap would continue to receive that amount, while those approved to open in 2003 and after would be subject to the new \$1,200 per-pupil cap.

Minnesota operates with a two-year state budget, within which the lease aid program is a line item for which a specific amount of money is allocated. The MDE bases its budget request for the program on the average per-student lease aid payments in the prior two years, combined with its projections of charter school enrollment for the next two years. In recent years, legislative appropriations have been sufficient to fully fund the amount for which each school qualifies. However, there have been years when appropriations were insufficient and per-student payments were reduced on a prorated basis. In theory, if budgeted funds proved to be insufficient due to changing circumstances (e.g., unexpected enrollment growth, dramatic marketwide increases in lease

costs), the legislature could make a midcourse supplemental appropriation.

Jon Schroeder, cofounder and former director of the Charter Friends National Network and now a senior associate at Minneapolis-based Education Evolving, a nonprofit established to help public education nationally with reform efforts, says charter school supporters in Minnesota realize they have one of the more generous state facilities aid programs. He describes the state's lease aid program as "an important factor in the overall relative fiscal equity enjoyed by Minnesota charter schools." Even though Schroeder believes the maximum grant amount should be periodically adjusted for inflation, he says he is grateful that the state has stood by its fiscal commitment to charter schools. Norman Chaffee notes that the vast majority of charter schools take advantage of the state's lease aid program. Chaffee asserts that the state facilities assistance substantially covers lease costs and sees the program as having been crucial to the expansion of charter schools in Minnesota.

*New Mexico.* Under New Mexico's Lease Payment Assistance program, charter schools receive varying levels of per-pupil grants based on the square footage of their facility. Program funding comes from a capped annual appropriation in the state budget, with no built-in mechanism to adjust the total allocation available from year to year for charter school enrollment growth. Nor does it directly adjust for shifts in local market costs, such as the price of real estate or construction. But New Mexico has increased funding each year, the result being that the average per-pupil grant has more than tripled from the original \$200 when the program was created in 2004. In school year 2007–08, the average

## Successful Efforts to Establish and Augment Facilities Aid: Arizona, Massachusetts, Minnesota, New Mexico, and D.C.

Many respondents from these five jurisdictions speak of having to overcome a high level of political resistance in order to create their facilities assistance programs and to maintain or increase the level of public support for charter school facilities aid. Collectively, they offer the following strategies, which they found to be effective in their efforts.

- **Educate legislative leadership.** According to Marc Kenen, executive director of the Massachusetts Charter Public School Association, the key to implementing a per-pupil facilities allocation in the state and, then, to gaining subsequent increases in funding, is connecting with and communicating information directly to legislative leadership. Pivotal to success in Massachusetts, he says, was “being able to turn one or two key legislative leaders into charter school advocates—and that has paid dividends to us for many years.”
- **Emphasize equity concerns for charter school students.** Respondents in three of the five jurisdictions profiled in this section point to the importance of focusing on equity issues when seeking facilities funding.
  - Lisa Grover, executive director of the New Mexico Coalition for Charter Schools (NMCCS), says her organization takes an equity perspective when seeking support for the Lease Payment Assistance program, reminding policymakers that when charter schools have to divert instructional dollars to pay for facilities, students may not be well served. Noting this approach has been helpful in winning support from the governor and legislature in New Mexico, she adds: “Every session we hear from some legislators saying, ‘We want to pull charter school [funding].’ So we go back to, ‘Why are we pulling [money] for charter school kids? Should we pull [the funding] for the rural students? Should we pull money for students in high-growth areas?’” Noting that it took two years for New Mexico to pass the lease assistance legislation, Grover says that justifying the need for it in equity terms was ultimately effective in moving policymakers to support it.
  - Grover’s views are echoed by Jon Schroeder, a senior associate at Minneapolis-based Education Evolving. He says the most effective strategy for overcoming resistance to charter school facilities support has been to educate legislators about the realities of charters, letting them know that some charters in Minnesota have been in “pretty inadequate space because they couldn’t afford better.” Then, he says, it’s a matter of reminding them that “it’s a matter of equity and it’s about the kids. . . . Our charter school students here tend to be disproportionately low-income, students of color, English language learners, and special education students. So why shouldn’t those students have the same money following them, including facilities, as [do the students in] the district system?”
  - Robert Cane, executive director of Friends of Choice in Urban Schools (FOCUS), describes a strategy his organization uses in Washington, D.C., to educate those who make funding decisions. He indicates that FOCUS takes charter school parents and students to city council meetings and hearings to talk about their facilities. In essence, he says, they have created a public relations campaign “trying to get people to understand that there is a good reason for [trying to establish] equity.”
- **Include provisions especially advantageous to charter schools in legislation that benefits all public schools.** Another strategy that has been effective in New Mexico, according to Grover, is to put forward proposals for which all schools are technically eligible, but which are especially beneficial to charter schools. New Mexico’s lease assistance program was crafted as part of a capital omnibus bill (i.e., wrapped up with other funding for public schools) because the NMCCS gauged that the funding program would not pass as a stand-alone bill. This grant program is open to all public schools, but 97 percent of the schools that take advantage of it are charters.



grant was \$700, and New Mexico Coalition for Charter Schools (NMCCS) has asked for \$1,000 per pupil for school year 2008–09. Lisa Grover, executive director of the NMCCS, says that with actual lease costs ranging from approximately \$1,100 to \$1,300 per pupil, the current state funding offsets a large portion of the lease burden. NMCCS also reports being successful in having the program extended to 2020 from its originally scheduled sunset date of 2010.

### ***Determining Degree of Flexibility in Use of Facilities-related Aid***

State policymakers who are designing policies to offset charter school facilities costs also need to consider how flexible or restrictive they want these policies to be. Will the monies be provided as a categorical funding stream, available only for facilities costs, or will they be more flexible? Will charter schools be restricted to using facilities aid only for leases, or be allowed to use this revenue to purchase or improve their buildings?

### ***Providing Greater Flexibility***

Arizona and Washington, D.C., offer fungible assistance to charter schools. This funding is intended primarily to offset expenses associated with facilities, but schools are given the discretion to use the money as they deem necessary for education purposes. In addition, this flexibility may encourage charter schools to be economical with facilities expenses, since they can use leftover funds for other purposes. However, Massachusetts, Minnesota, and New Mexico offer categorical facilities aid (i.e., aid that may be used only for facilities). In the latter two states, the laws governing this aid further restricts it to covering lease costs rather than

purchase, construction, or mortgage repayment costs. Notable aspects of the policies of the states mentioned above that may be useful to policymakers as they consider enacting or amending facilities aid legislation are discussed further below.

Arizona’s charter law explicitly makes charter school aid flexible. It stipulates that funds intended to offset the facilities costs of charter schools be included in general state aid without categorical distinctions between operations and capital. This aid for Arizona public schools (both charter and traditional) is called “equalization assistance.” For charter schools, the aid consists of a “base support level” and “additional assistance,” which is intended to fund charter schools’ capital expenses and transportation.<sup>20</sup> Charter schools receive this assistance as a per-pupil allocation that can be spent as a school sees fit.

According to Jay Kaprosy, former legislative liaison for the Arizona Department of Education and currently assisting ACSA with government relations, when the original charter school legislation was enacted in 1994, there was support for creating flexible funding mechanisms for the schools because they were seen as “laboratories of change.” Subsequent amendments adopted since have been aimed at increasing that flexibility. Kaprosy says the most notable change came with the consolidation of four funding categories—three for capital and one for transportation—into a single and flexible lump sum per pupil, absent any operational or capital distinctions.

Kaprosy adds that the equalization assistance has been a key tool for providing charter schools

with increased operational flexibility. Allowing charter school operators to use funding dollars as needed, he argues, permits them to run the schools as businesses and to make decisions that are in the best interest of the students and families they serve.

Similarly, in Washington, D.C., the *School Reform Act of 1995* gave charters the discretion to make decisions about how to use their Facilities Allowance. According to Robert Cane, executive director of FOCUS, the statute specifies that charter schools and their boards have “exclusive control” over expenditures, administration, personnel, and instructional methods, within specified limitations.<sup>21</sup> Charter administrators, says Cane, use this statutory language (i.e., “exclusive control over expenditures”) to justify their right to direct per-pupil facilities assistance as they deem necessary. In Cane’s view, the advantage of funding that can be used in multiple ways is that some charters use their entire facilities allowance on their buildings, while others “put some of that money aside to help develop their balance sheets.”<sup>22</sup> Cane explains that charter schools typically start out by leasing space when enrollment and revenue are low, with the ultimate goal of purchasing and moving into a larger or permanent facility as they grow. The ability to save some of their facilities aid allows charter schools to build an asset base (i.e., develop a balance sheet), thus making it more likely that lenders will finance future facilities purchases.

### **Imposing Restrictions on Use of Facilities Aid**

Other states have taken a more restrictive approach. In Minnesota, state legislators stipulated in the Per-pupil Building Lease Aid program that

charters are prohibited from purchasing or owning their buildings. Schroeder recalls that when the original charter legislation was passed, facilities financing was barely considered. In other parts of the country, legislators assumed that charter schools would finance their facilities out of their operating revenue. Early on, Schroeder says, “There was really a feeling that this was a new form of public education—untested—and that, particularly until it got established and was proven permanent and sustainable, [the state] didn’t want to get into [the] business of being a landlord” that would have to dispose of assets if charter schools closed. Thus, the state staked out the position that charters could not use public funds to buy buildings, and it initially provided no explicit funding or financing for facilities. Even when the burden of facilities costs for charter schools quickly became apparent and the state enacted its lease aid program, it stood by that original position, specifically prohibiting public funds from being used to purchase or build a facility.

According to consultant Norman Chaffee, this prohibition poses a challenge to Minnesota’s charter schools as they strive to buy or to pay for needed improvements in buildings they lease. Unable to use the lease funds, they either have to divert money from operational revenue, raise new money, or find creative solutions. One such solution is for a charter school to establish a partnership with a nonprofit building corporation or to create its own nonprofit building corporation. Using this strategy, the building corporation buys and improves a facility for the school and, in turn, the charter operators pay their state lease aid to the building corporation as rent payments. Chaffee says some 20 to 30 percent of charter operators across the state



## A Closer Look at Direct Cash Assistance Friendship Public Charter School, Washington, D.C.

Since it was founded in 1998, Friendship Public Charter School has used a variety of funding sources to renovate and operate its five school facilities in Washington, D.C.

To renovate its first four campuses in preparation for opening them between 1998 and 2005, Friendship School sought financing through Edison Schools, a charter school management company, and Bank of America. In 2003, the school borrowed nearly \$45 million through the District of Columbia's tax-exempt revenue bond program to improve its school buildings (including constructing a new addition to one), invest in information technology, and repay its loans to Edison and the bank. Three years later, Friendship School obtained another \$15 million through the bond program. These funds were intended to pay for new construction and improvements to a fifth school, as well as new technology, fixtures, furniture, and equipment.

Like other charter schools in Washington, D.C., Friendship School receives substantial assistance from the District's facilities allowance of \$3,109 per pupil. This allowance is one of three per-pupil grants the school receives from the District government (it also receives a base allotment and a special education allotment). The facilities allowance is generally intended for facilities costs, but schools are given considerable discretion over how it is spent and can, if needed, also use the funds for educational programming. In the case of Friendship School, virtually all of these funds have been needed to cover the full cost of facilities—including loan payments, utilities, maintenance, repairs, and replacement reserves.

According to the schools' operators, this direct cash assistance is a reliable and painless source of revenue. They receive payments on a regular basis and are given relatively wide latitude in how they spend it. The only drawback, Friendship School operators say, is that there is no guarantee that the allowance will be maintained indefinitely at the same or a higher level. (There is a mechanism to adjust for rising capital costs from year to year, but some District council members have suggested that these payments should be capped over the long term, rather than continuing to increase along with the per-pupil capital investment in other District public schools.) This lack of certainty makes the schools somewhat less attractive to lenders or investors who would prefer to see that stream of funding locked in place.

Overall, however, the direct assistance is an invaluable asset for Friendship School and its operators are hard-pressed to say how they would cover their facilities expenses without it. By covering (or substantially offsetting) facilities costs, this direct assistance provides the organization with a basic level of financial security that charter schools in many states do not have. Moreover, it has allowed Friendship to build up equity to serve as valuable collateral, making it easier for the organization to borrow millions of dollars from bond investors.

### Friendship Public Charter School: Selected Statistics

Year Opened	Grade Levels	Number of Students	Number of Campuses	Student Ethnicity	Special Education	Free and Reduced-Price Lunch
1998	Pre-K–5 Pre-K–8 6–8 9–12 K–8	3,830 total in all 5 schools	5	95% African-American across all 5 schools	5.7% in grades K–5 and 9.8% in grades 6–12 across all 5 schools	66% across all 5 schools

**Source:** Data in first six columns are from "Appendix A: Friendship Public Charter Schools Inc.: General Information," in untitled Friendship School bond transaction document. Information in last column is from District of Columbia Public Charter School Board, *School Performance Reports* (December 2007).

(approximately 30 to 40 schools) are moving in this direction. However, the basic policy debate around whether charters should be allowed to use state aid to construct or improve buildings has not been resolved yet.

## Policy Considerations Regarding Direct Cash Assistance for Facilities

Interview respondents from the five jurisdictions with relatively high per-pupil facilities aid generally express satisfaction with their current funding models. But they suggest that policymakers consider:

- *Adjusting funding formulas for growth in charter enrollment.* Three of the five entities profiled in this section (Arizona, Massachusetts, and Washington, D.C.) have annual allocation formulas designed to take enrollment growth into account. Others would like to move in this direction. In New Mexico, the NMCCS seeks to change the state's funding model so that the overall program funding level each year is based, in part, on changes in charter enrollment.
- *Adjusting funding formulas for inflation, particularly in facilities-related costs.* Arizona respondents Sigmund and Kaprosy

argue that the amount of aid for charter facilities should grow at the rate of a construction inflation index, which Arizona uses to adjust traditional public schools' funding when capital costs significantly increase. Sigmund points out that while Arizona's index has increased more than 12 percent per square foot over the past two years, the amount of facilities assistance for charter schools in the state has increased only 2 percent over the same period.<sup>23</sup> Noting that Minnesota's lease aid grant amount also is due for an inflation adjustment, Schroeder suggests that states create adjustment mechanisms that account for local variations in the costs of living and construction.

- *Allowing flexibility in use of state aid intended to assist with cost of charter school facilities.* Two jurisdictions highlighted in this guide for their facilities aid approaches (Arizona and Washington, D.C.) offer charter schools the flexibility to direct these funds where they deem them most needed. By not restricting this use of funding, these jurisdictions may encourage charter schools to be economical in their choices related to facilities because any leftover funds can be directed toward other needs. Many respondents cited the value of such flexibility.





## PART II

# Ability to Borrow Money

*When public funds are not available or are insufficient for charter school facilities, operators who need an infusion of capital, whether to buy a building or to improve facilities they own or lease, typically have to borrow the funds. Yet, absent state policy support, several inherent and overlapping characteristics of charter schools can make it difficult for them to access low-cost financing.*

**Lack of tax base.** Traditional public schools typically rely on their school district, local government, or some combination of both, to cover facility-related costs, using funds generated by local property taxes. If needed, a district or local government can borrow against future tax revenue and, in some instances, can use the ballot box to ask voters for additional funds, often in the form of general obligation bonds—a designation meaning the bonds are backed by the credit or taxing power of the issuing jurisdiction. In contrast, charter schools have no direct access to this public revenue stream. Even if they did, there would be the question of whom to tax, because charter schools typically have no geographic boundaries. Without a taxpayer pledge of fiscal support over a defined period of time, which would provide a source of consistent revenue to pay off a loan, charter schools are less appealing to lenders who, if willing to loan at all, are likely to demand a higher interest rate.

**Higher risk.** Unlike traditional public schools, charter schools have the potential to go out of business (e.g., lose their charter and, thus, their

per-student funding, or declare bankruptcy), which is a key reason lenders tend to view the schools as relatively risky borrowers.<sup>24</sup> Compounding this are perceived risks associated with charter schools' lack of regular tax revenue to repay loans. As a result, the interest rate charter schools pay on loans is typically higher than it would be for a traditional school district using general obligation bond financing.

**Limitations on access to tax-exempt bonding.** Because charter schools lack a tax base, their ability to raise money through bonds is significantly limited compared to that of a traditional school district. The bonds that traditional school districts often issue, directly or indirectly, to finance school facilities are attractive to some investors because the bonds offer the safety of what is effectively a government guarantee of the investment (as well as, typically, tax exemption on their interest earnings). In turn, these investors are willing to accept a lower interest rate. Yet this relatively low-cost financing strategy is not readily accessible to all charter schools.<sup>25</sup>

## Legislative Efforts to Improve Affordability

Lawmakers in several states and Washington, D.C., have enacted policies intended to broaden charter schools' access to affordable financing options. Although there are significant overlaps, generally speaking, most fall into one of two categories: the first category relates most directly to making affordable financing more easily available to charter schools, and the second focuses on addressing lenders' concerns about the risk of investing in charter schools, thereby encouraging investors to loan money at lower interest rates.

Efforts aimed at improving affordability and accessibility include:

- Authorizing tax-exempt conduit financing, which allows charter schools to indirectly issue tax-exempt bonds;
- Allowing charter schools to participate in the federal bond program, Qualified Zone Academy Bonds, that pays investors with tax credits rather than interest; and
- Setting up low-cost loan programs for charter schools.

Policy efforts aimed at increasing the affordability of financing for charter school facilities by making investments less risky include:

- Allowing school districts to incorporate charter facilities in their own tax-exempt, general obligation bond requests to voters;
- Giving charter schools access to a moral obligation provision for their bonds, which adds security to a bond;
- Creating an intercept mechanism through which part of a charter school's per-student

state revenue can be diverted directly to pay lenders;

- Giving charter school operators access to a debt-service reserve fund; and
- Clarifying charter schools' "public entity" status to help ensure their ability to pursue litigation if the operators believe their charter has been unreasonably cancelled or not renewed.

All of these policy strategies are discussed below.

## Different Kinds of Loans

Charter schools can borrow money in one of two primary ways. The first is through a traditional loan and the second is through bond financing.\* In both instances, without governmental or other intervention, financing costs for charter schools can be relatively high. A third, less common method charter schools have been able to use to obtain loans for their facilities is through a publicly funded loan program. This section discusses how some jurisdictions are attempting to make financing more affordable for charter schools.

### *Allowing Charter Schools to Indirectly Issue Bonds*

Most states and Washington, D.C., attempt to make bond financing as affordable as possible for charter schools by allowing them to utilize public bonding authority, giving them the ability to directly or indirectly issue tax-exempt

\* Readers who are unfamiliar with the fundamentals of bond financing can find a very basic overview in the box on p. 19 entitled, "Basic Bond Concepts and Terminology."

## Basic Bond Concepts and Terminology

The information on this page is intended to help those without any finance background to better understand this guide's discussion of bonds as a borrowing mechanism for charter school operators seeking financing for their facilities. It provides a very general overview and explains some key terminology related to this security.

A bond is a loan made to a borrower (e.g., a charter school) by an investor for a defined period at a specified interest rate (which can be fixed or variable). Interest is typically paid periodically at set dates over the life of the bond. Principal also is repaid over the life of the loan, with the last payment made on the bond's "maturity date." The length of time from bond issue to maturity date—its term—can be as little as a year or less or as long as 50 years or more. In the context of school facilities finance, common terms are 20 to 30 years.

Various factors contribute to the interest rates on bonds and, therefore, to the affordability of the financing. Current market interest rates play a role, as do the length of the term and the strength of the "credit" or the financial strength of the borrower. Generally, the longer the investors' money will be tied up, the higher the interest rate. Other factors that influence the interest rate on bond issues are risks to the investor (i.e., lender) and any tax consequences. Municipal bonds, issued by a governmental entity (e.g., a state, a city, a school district) or its agent, are most often (but not always) tax-exempt. For investors, the advantage of tax-exempt municipal bonds is that they do not have to pay income tax on interest earnings; the advantage for the borrower is that, in exchange for the tax exemption, investors are willing to accept lower interest rates.<sup>26</sup>

The relative risk for investors who buy municipal bonds depends, in part, on whether the bonds are a "general" or "limited" obligation, designations that relate to how a loan is secured and, therefore, how safe it is considered to be. General obligation bonds are considered the safer of the two types because, as noted earlier, they are backed by the credit or the taxing power of the governmental body issuing them. In contrast, limited obligation bonds, also called revenue bonds, are secured with the pledge of a specific tax or revenue stream (such as when transportation bonds are paid off by tolls). In general, bonds are rated by private, independent rating services (e.g., Standard & Poor's, Moody's, Fitch) according to the borrower's financial strength and ability to pay investors as promised.<sup>27</sup> That said, according to one respondent interviewed for this guide, many bonds issued on behalf of charter schools are not rated.

A key player in the bond-issuing process is the underwriter, often an investment bank, whose role is to structure the transaction and sell the bonds to investors. Some borrowers hire financial advisors, who can counsel them as the transaction progresses and can help an issuer take bids from various underwriters to see who offers the best deal. Every tax-exempt bond requires the opinion of nationally recognized "bond counsel," and the disclosure documents required by securities laws are prepared by "disclosure counsel." Some borrowers obtain a letter of credit from a bank, which guarantees payment of the bonds and, therefore, reduces the interest rate the borrower must pay. Once the bonds have been sold, the borrower makes interest and principal payments to the investor, usually through a trustee, who is hired to receive all payments and distribute them to individual investors. The costs of the players mentioned above (e.g., underwriters, financial advisors, attorneys), plus other fees that may be charged, must be figured into the costs of a bond issue to help a borrower determine whether the lower tax-exempt interest rate is worth pursuing.



bonds (usually limited obligation or revenue, not general obligation, bonds). As public entities with taxing authority, local school districts have long had access to this low-cost financing mechanism. Those jurisdictions wishing to give the same opportunity to charter schools have done so by making it clear in statute that local government and other public finance authorities are empowered to issue tax-exempt bonds on behalf of charter schools. These are known as conduit issuers. In some instances, lawmakers have given this authority to existing governmental entities, such as public finance authorities; in others, they have created a new entity vested with the authority to issue bonds on behalf of charter schools. Either way, explicitly authorizing conduit issuers has been the most prevalent strategy thus far for allowing charter schools to borrow at a relatively affordable cost.

According to a 2007 study by Local Initiatives Support Corporation (LISC), a nonprofit community-based development organization, about two-thirds of the states with charter school legislation, plus the District, have made charter schools eligible to access tax-exempt bonds through conduit issuers. Seventeen states have a statewide (or, in the case of the District, district-wide) conduit issuer that has issued tax-exempt municipal bonds to finance charter facilities.<sup>28</sup> The ability of these organizations to issue tax-exempt bonds on behalf of charter schools lowers borrowing costs for the schools.

All conduit issuers charge fees for their services, although the services included and the mechanisms for calculating the fees vary. Their fees vary, too: Some conduits charge a fixed one-time amount, some charge annual fees that vary based on the size of the principal, some charge

variable one-time fees, and still others charge both an initial fee and subsequent annual fees. These fees generally come on top of additional charges associated with any bond issuance (e.g., those from the underwriter with whom a conduit works to issue the bonds or from a legal or financial advisor [or, in some cases, both] who might be involved in the process). However, some conduits provide some of these services. A charter school seeking to finance its facilities through bonds also must be prepared to pay whatever interest rate lenders require. This rate is not set by the conduit issuer, but by the market, and is influenced by the school's creditworthiness.

Table 3 on page 21 lists state-authorized conduit issuers in four states—Colorado, Massachusetts, Michigan, and Texas—and a district-authorized conduit in Washington, D.C., which are among the most active nationwide in issuing tax-exempt bonds for charter schools. In some of these jurisdictions, charter schools also have access to local-level or countywide conduit issuers. But, based on the high level of tax-exempt bond offerings that these five conduits have issued on behalf of charter schools, each seems to be a predominant issuer in its jurisdiction. The role that each of these conduit issuers has played in the charter bond market in its respective area is discussed below.

*Colorado.* In 1998, Colorado became one of the first states to grant charter schools the ability to issue tax-exempt bonds through a public authority when the state legislature gave an existing conduit issuer, the Colorado Educational and Cultural Facilities Authority (CECFA), the ability to issue bonds on behalf of charter schools.<sup>29</sup> CECFA began issuing bonds for charters in 1999.

**Table 3.** Features of Selected State-authorized Conduit-issuer Financing for Charter School Facilities

Conduit Issuer	Year Conduit Began Issuing on Behalf of Charter Schools	Approximate Amount Issued to Date (in millions)	Number of Bond Issuances/ Number of Schools
Colorado Educational and Cultural Facilities Authority (CECFA)	1999	\$701	78 transactions/ 50 schools
Massachusetts Development Finance Agency (MassDevelopment)	1999	\$168	19 transactions/ 14 schools
Michigan Public Educational Facilities Authority (MPEFA)	2003	\$92	14 transactions/ 13 schools
Texas Public Finance Authority (TPFA) Charter School Finance Corporation	2004	\$130	6 transactions/ 6 schools
District of Columbia City Government	2001	\$197.7	19 transactions/ 13 schools

**Note:** A conduit issuer is a public entity, such as a state bonding agency or a city, that may issue a tax-exempt bond on behalf of a third party, such as a hospital or a charter school.

**Source:** Phone interviews conducted for this guide with staff from the state-authorized conduit issuers listed in the table.

According to Jim Griffin, president of the Colorado League of Charter Schools (League), his members consider CECFA to be “a very capable, active, and helpful conduit financier.” Although CECFA’s fees were relatively high to begin with, he says, once it started doing a significant volume in charter bonds, it reduced its fees, and the costs to charter schools became reasonable. In recent years, the governing board of CECFA has voted to reduce its annual fees by 50 to 75 percent.

Bill Dougherty, a financial advisor to CECFA, says that, prior to expansion of the conduit’s scope, the financing environment for charter facilities had been “predatory in nature.” In the early- to mid-1990s, after the first Colorado charter school bill passed, new schools were forming without any established way for them

to borrow capital. Dougherty characterizes it as a time when the “very few providers” (i.e., lenders, investors, and underwriters) were demanding “very high interest rates at onerous terms” on such financing options as commercial mortgage loans and taxable bonds. When charter schools started to push for less expensive ways to finance the capital they needed for facilities, the logical step was to give them access to CECFA and, through it, to tax-exempt bonds.

Gradually, according to both Dougherty and Jo Ann Soker, CECFA’s executive director, as the charter school bond market has developed through the work of this conduit issuer, so, too, has the financial acumen of charter school operators in the state. One result is that some charter school operators secured investment-grade ratings for their bonds due to their school’s strong



fiscal operations. Because higher ratings allow schools to realize lower interest rates on their bonds, these schools can achieve lower ongoing financing costs.

**Massachusetts.** The Massachusetts Development Finance Agency (MassDevelopment) is the Commonwealth's finance and development authority, legislated into existence for the purpose of providing businesses and local officials in distressed communities with financial and real estate tools and expertise to stimulate economic growth in the state. Helping to finance charter school facilities in these communities is intended to spur the state's economic growth by creating jobs (e.g., from building construction or renovation), as well as by supporting education. One of MassDevelopment's roles is acting as a conduit to issue tax-exempt bonds for charter schools. Once a charter school decides to seek bond funding for its facility, MassDevelopment guides the school through the process. In addition, its staff may advise school operators on related issues, such as real estate and building renovation, areas of expertise for the organization derived from its overall economic development charge. Marc Kenen, executive director of the Massachusetts Charter Public School Association, says that, given the inherent complexity of issuing charter school bonds, having MassDevelopment facilitate the process is almost as important as its ability to issue the tax-exempt bonds. He adds that the charter community considers the agency to be especially helpful in pre-project planning; instances of this include guiding operators through the basic components involved in renovating a building (e.g., role of an appraiser, state requirements, environmental regulations) and helping school

operators explore alternative financing, such as federally funded loans, for their projects.

**Michigan.** A major role of the Michigan Public Educational Facilities Authority (MPEFA or Authority), created in 2002, has been helping charter schools—known in Michigan as public school academies—to acquire tax-exempt bond financing. Since 2003, MPEFA has been an active conduit issuer for charter schools (see table 3 on p. 21) and, as of July 2008, it was working on an additional \$88 million in bond deals for nine schools.

MPEFA financial manager Kathleen O'Keefe notes that this conduit issuer provides some benefits that commercial financiers cannot offer. For example, as will be detailed later in this section, MPEFA can intercept a charter school's per-pupil funding from the state, diverting it to pay bondholders directly, a service that makes the bonds more appealing to buyers because it decreases the risk that schools will pay their lenders late or not at all. In the same vein, she says, the Authority's close relationship with the Michigan Department of Education allows it to productively and quickly deal with "any hiccups in state aid payments" that otherwise might interfere with charter schools making timely payment on bond debt.\*

According to Dan Quisenberry, president of the Michigan Association of Public School Academies (MAPSA), one important aspect of MPEFA's work is that, by creating a "healthy infrastructure" for charter schools to seek bond funding, it has fueled the development of a bond-

\* Charter schools frequently use state aid to pay back bondholders.

financing market in Michigan for charter schools. This has come about in part, Quisenberry says, because the conduit issuer's oversight on bond deals has given investors more comfort in buying charter school bonds.

*Texas.* In 2003, the Texas Public Finance Authority (TPFA)—a state agency that since 1984 has provided capital financing for state agencies and certain public institutions of higher education—established the Charter School Finance Corporation (CSFC) as a nonprofit corporation under Chapter 53 of the Texas *Education Code*.<sup>30</sup> An amendment to the Texas *Education Code* enabled the authority to create the CSFC to issue bonds specifically for the acquisition, construction, repair, or renovation of facilities for open-enrollment charter schools.<sup>31</sup> Other local conduit issuers in Texas also are able to issue bonds on behalf of charter schools and began doing so in 1999, with the first bond issue closing in early 2000.

Kim Edwards, executive director of the TPFA at the time this guide was researched, notes that in Texas school finance is decentralized. Among other things, this means that under state statute, there is no geographic restriction on local conduit issuers; so, for example, a school in Houston can have bonds issued by a conduit issuer located in Dallas. Thus, the state's charter schools can choose to work with any one of a variety of municipal conduits in addition to the TPFA. As of June 2008, TPFA had issued over \$130 million in bonds for six schools, which constituted over 40 percent of the dollar amount of the state's bond issuances to date for charter school facilities. The bond issues handled by the TPFA have tended to be larger than those handled by local conduits; for example, there

was a \$35 million issue for KIPP (Knowledge Is Power Program) in Houston and a \$37 million issue for IDEA Public Schools in various locations in the state. Edwards attributes these larger bond deals, in part, to the fact that the schools for which TPFA has issued bonds have tended to be larger and more established than others in the state, making them relatively more appealing investments.

*Washington, D.C.* The *District of Columbia Home Rule Act* authorizes the District to issue tax-exempt bonds for the acquisition, construction, and renovation of eligible capital projects that are owned by nonprofits, including charter schools.<sup>32</sup> The District created the Revenue Bond Program, which is administered under the Office of the Deputy Mayor for Planning and Economic Development. According to program director William A. Liggins, to qualify for the program, charter schools must receive tax approval and planning approval, if needed (e.g., zoning variance) from various agencies, as well as a memorandum of understanding from the District's charter school board. In addition to the relatively high volume of bond transactions the District had completed for charter schools as of December 2008 (as shown in table 3), five additional revenue bond issues worth \$103.2 million were pending. Because the bonds issued through the program are tax-exempt, says Liggins, the longer-term bonds tend to have interest rates that are 2 to 3 percentage points lower than those on taxable bonds with the same term. In addition, he notes, his office has made an effort to expedite the issuing process; applications are generally reviewed, sent to various agencies for their approval, and voted on by the city council within 90 days—a relatively short time span, as it is not uncommon within

the charter school bond world for it to take up to a year to structure and close charter school bond deals. Even when glitches come up, such as tax or zoning problems, Liggins says, they are usually resolved quickly and the deals are approved within 120 days.

### **Allowing Charter Schools to Directly Issue Bonds**

Another way for state policymakers to provide charter schools with tax benefits aimed at alleviating the burden of facilities costs is to establish the legal framework for the schools to issue tax-exempt debt directly. By giving charter schools the power to issue bonds on their own behalf, rather than rely on conduit issuers, legislators could help schools further reduce their bond transaction costs.

Thus far, this policy alternative remains primarily a theoretical option. A recent development in Michigan, however, has opened the door to giving charter schools authority to directly issue their own tax-exempt bonds. Michigan's *Revised School Code, Act 451 of 1976*, provides the state's charter schools, known as public school academies, with statutory authority to issue bonds, as do traditional public schools. For many years, however, it was unclear whether the obligations of such schools could be issued directly on a tax-exempt basis.<sup>33</sup>

As part of its audit of Summit Academy North charter school in Romulus, Mich., the Internal Revenue Service (IRS) confirmed in a 2006 technical advice memorandum (TAM) that "a public school academy [i.e., charter school] is permitted to borrow money and issue tax-exempt bonds."<sup>34</sup> An attorney commenting in

the *Bond Buyer* about this IRS memorandum speculated that the ruling could be a helpful for charter schools across the country, given that many states have similar laws establishing that charter schools are public schools and, further, that they have the authority to issue bonds.<sup>35</sup>

The IRS became interested in these issues because of a legal opinion accompanying a lease-purchase agreement that Summit Academy North entered into with Ohio-based Park National Bank in 1998. The opinion, written by the law firm counseling the academy, indicated that interest payments on the debt were tax-exempt because the academy was a "political subdivision" of the state.<sup>36</sup> While the TAM concluded that the academy was not a political subdivision of the state, it also concluded that, as a public school and as structured under its particular charter agreement (which was granted by a Michigan university), the academy was carrying out governmental functions as an extension of the state and, therefore, should be able to issue tax-exempt bonds.<sup>37</sup>

Since this 2006 IRS decision, the state of Michigan has not tracked how many other charter schools have taken advantage of the ability to issue tax-exempt debt directly. Nor is it clear how broadly applicable the TAM might be beyond the particular facts and circumstances of this case. MAPSA's Quisenberry says his impression is that a few other charter school operators have issued debt in this fashion and that, among charter school operators, it is considered a welcome alternative but probably not a far-reaching solution to the facilities-funding challenge. Simply because charter schools have the legal right to issue tax-exempt debt themselves, he

## Bond Financing Is Not Cost-effective for All Schools

Policymakers' efforts to increase charter schools' access to affordable bond financing have helped many charter schools open their doors and improve the quality of their facilities. Increasing the availability for this type of financing for charter schools across the country would likely help many more. But despite the promise this strategy holds, it is not a perfect solution for every charter school. Simply put, affordability is relative and, even with the best intentions on the part of policymakers, carefully crafted initiatives to lower the cost of financing do not necessarily result in costs that all charter schools can manage.

The reality for start-up and small charter schools is that it typically is not feasible for them to take advantage of these types of borrowing mechanisms.<sup>38</sup> Bond deals typically entail high fixed costs, including those related to banking, legal, and conduit issuer transaction fees. Charter operators have to assess the transaction costs against the savings that can be achieved with this type of financing. According to Jim Griffin of the Colorado League of Charter Schools, "Deals under \$2 million don't get done anymore because it's just not worth it"—that is, the necessary expenses outweigh any potential savings.

Even for new or small schools that want to finance projects at this level or above, relatively low-cost bond-financing options may be out of reach. Bond buyers generally demand that charter schools have sufficient cash flow to repay their loans. State per-pupil revenue is commonly used to repay debt and to accumulate a cash surplus, but charter schools in the start-up phase have not yet had much opportunity to accumulate these dollars and, in addition, have to take on many one-time expenses associated with opening a school. Likewise, small schools receive per-pupil funding commensurate with their relatively low enrollment. Therefore, many investors are concerned that these types of charter schools lack the financial solvency necessary to enter into a bond deal. In Michigan, Kathy O'Keefe of the Michigan Public Educational Facilities Authority confirms that investors in her state are frequently worried that start-up and small schools do not have an adequate cash flow to manage a bond deal.

O'Keefe adds that in Michigan, as is not uncommon in other jurisdictions, such schools are more likely to be authorized for short terms (e.g., five to six years), which is at odds with the terms of most bond deals (i.e., 20 to 30 years). Concern that a charter school's contract might be terminated well before the bond debt is paid off is another barrier diminishing access to this financing. (See the section "Mitigation of Investor Risk" on p. 29 for more information about the efforts of several states and Washington, D.C., to enhance charter schools' creditworthiness.)

In a state like Colorado, which has relatively well-developed supports in place to help charter schools access bonds, unexpected challenges related to charter school borrowing have developed. Griffin says that Colorado's strong bond market may have inhibited the growth of other lending options for charter schools. He explains that the number of more traditional banks that will offer taxable loans to charter schools in the state is lower than ideal "because the bond deals have almost filled the whole space."

says, does not mean that the market will allow all schools to do so. He suggests that for charter schools that are considered a high risk, such as those in the start-up phase, issuing through a conduit may give potential investors an added layer of security.

### *Compensating Investors With Tax Credits in Lieu of Interest*

As an incentive to invest in charter schools, state policymakers can make federal tax breaks available to investors. This option is intended

to accomplish the same policy objective as tax-exempt financing by creating opportunities for charter schools to obtain more favorable financing terms.<sup>39</sup> Several states have moved to make charter schools eligible to participate in their state's allocation of Qualified Zone Academy Bond (QZAB) tax credits.<sup>40</sup>

The federally sponsored QZAB program allows public schools (including charter schools) to issue the tax-credit bonds if the school is located in an empowerment zone or enterprise community or is serving a population in which 35 percent or more of its students are qualified to receive free or reduced-price lunch. In addition, to qualify for QZAB allocations, a school or district is required to raise a contribution from private business equal to at least 10 percent of the proceeds from the bond issue. Proceeds from QZABs may not be used for construction of new facilities, but can be used for a variety of other school-related needs, including rehabilitation or repair of facilities. Investors earn tax credits, which make them willing to accept lower interest payments, thus reducing the cost of borrowing for charter schools.

Congress has authorized \$400 million for the QZAB program each year since 1998, parceling out allocations of QZAB tax credits to states and territories based on the percentage of their population living below the poverty line.<sup>41</sup> States have the authority to determine whether to allocate some portion of their QZAB allocation to charter schools, as well as to determine the amount of that allocation, if any.<sup>42</sup>

The QZAB program was conceived largely as a way of subsidizing school renovations in low-income communities by allowing schools to

shift the interest payments on their financing from the borrower (i.e., the school) to the federal government. QZABs differ from tax-exempt bonds, for which the borrower pays interest, albeit at a relatively lower rate, since the investor does not have to pay tax on QZAB earnings. The U.S. Department of Treasury is supposed to set a tax credit rate on QZABs so that, on average, school districts that use the program will pay no interest. For example, investors might need to receive tax credits at the same rate they receive interest on corporate bonds with an "A" rating (e.g., 8 percent) in order for the investors to require no interest. Under this scenario, the Treasury would use the interest rate of A-rated corporate bonds as the rate at which it would provide tax credits on QZABs. For every dollar investors held in QZABs, therefore, they would receive 8 cents a year in tax credits until the bond matured. As a general rule, QZABs cut the cost of financing by half, according to an estimate in a 2004 Education Evolving report.<sup>43</sup>

According to a 2007 study by Local Initiatives Support Corporation (LISC), which provides a catalog of financing options available for charter school facilities nationally, only 24 of the 41 jurisdictions with charter legislation expressly make charter schools eligible to participate in their QZAB programs, with four more having no explicit prohibition against charter schools' participation.<sup>44</sup> The LISC report also found that, as of 2007, charter schools in several jurisdictions (Arizona, California, Massachusetts, Michigan, Wisconsin, and the District) had issued QZABs. Among the jurisdictions featured in this guide, five have issued QZABs to charter schools—Arizona, California, Massachusetts, Michigan, and the District. These five jurisdictions are



among the most active nationwide in allocating QZAB credits to charter schools.

As of August 2008, approximately \$3.5 million in QZAB credits had been allocated to Arizona charter schools according to Steven Race, chief financial officer at the Arizona Department of Education, which administers the state's allocation of QZAB credits. All public schools, including traditional and charter schools, that meet the federal eligibility criteria may apply to participate in the state's QZAB program. Arizona's QZAB credits are allocated to eligible applicants on a first-come, first-served basis.

California charter schools may apply to participate in the state's QZAB program either directly or through their authorizing districts.<sup>45</sup> California Department of Education (CDE) staff are charged with reviewing and awarding QZAB applications. They score project proposals based on the clarity and strength of required application elements (e.g., descriptions of the pledged contributions from private business). The application process and eligibility requirements are the same for charter schools as they are for traditional public school districts, except that a charter school applying separately from its authorizing district must inform and solicit support from its authorizer. According to Shannon Farrell-Hart, education fiscal services consultant in the CDE's School Facilities Planning Division, as of August 2008, the state had allocated \$14 million in QZAB credits for charter schools, with another \$2.5 million pending and expected to close later in the year.

Qualified public schools in Massachusetts, including charters, are eligible to participate in the state's QZAB program on a first-come, first-

served basis, according to Cliff Chuang, coordinator of Charter School Research and Finance at the Massachusetts Department of Elementary and Secondary Education, which helps administer the program and allocate the state's QZAB credits. Chuang reports that since 1998 \$33.6 million, representing 83 percent of the state's total QZAB allocations, has been issued on behalf of seven charter schools, with MassDevelopment serving as the conduit issuer for most of the QZAB deals.

However, there has never been an over-demand for QZAB allocations in the state because they entail complicated financial transactions and strict eligibility requirements, says Chuang, adding, "You can't go into this without sophisticated financial expertise. Then you need to have a consultant who really knows what he or she is doing, somebody who has studied [QZABs]." The need for this level of technical expertise means that schools must hire private consultants, resulting in higher transaction costs. Charter schools that have applied for QZABs have tended to be the state's larger, more established operators, according to the Massachusetts Charter Public School Association's Marc Kenen.

In Michigan, as of August 2008, the state had allocated about \$3.7 million in QZAB credits for charter schools (or "public school academies" as they are known in the state), according to Andy DeYoung, an analyst in the Office of Grants Coordination and School Support at the Michigan Department of Education, which administers the state's QZAB program. As in Arizona and Massachusetts, all public schools in Michigan that meet the federal qualifications, including charter schools, are eligible to receive QZAB allocations on a first-come, first-served basis.

Charter schools are eligible to participate in the District's QZAB program as well. As of August 2008, the District had allocated \$4.9 million in QZAB credits for charter schools, according to Liggins from the District's Office of the Deputy Mayor for Planning and Economic Development. Staff of this office are responsible for reviewing QZAB applications in the District and determining which of these will be presented to the city council for approval. Criteria used to evaluate applications include many considerations, such as the specific school improvements proposed, the level of need for physical improvements at each school applying, and the level of economic development in the area where the school is located. In addition, approval of QZAB applications submitted by charter schools takes into account whether the schools are in good standing with their chartering authorizers. Echoing Chuang's concerns about the difficulty of accessing QZAB funds, Liggins also notes that because of the complexity of the QZAB rules and regulations, it is challenging for charter schools to satisfy all of the associated credit requirements.

Additionally, Congress adopted the *Tax Relief and Health Care Act of 2006*, imposing restrictions on QZABs. This statute subjects QZAB issuers to the same arbitrage regulations as those that apply to tax-exempt bonds.<sup>46</sup> In this context, arbitrage is profiting by borrowing at one interest rate, then investing the borrowed funds to earn a *higher* interest rate. While some say that investor interest in QZABs has declined in recent years due to overall market conditions, respondents from California, Massachusetts, and Washington, D.C., report that the new requirements have lessened the appeal of QZABs for investors and issuers alike.

In fact, Liggins suggests that by adding tax constraints that reduce the total amount of money that can be issued to schools, the new restrictions are at odds with the overall goal of the QZAB program, which is to give significantly lower-cost financing to qualifying schools. Whatever the reason, fewer QZAB deals have been packaged in the District recently, and Liggins anticipates that there will probably be an even greater slowdown in the future. Likewise, Rebecca Sullivan of MassDevelopment says her state has not used many QZAB allocations since these changes took effect. Chuang quantifies that observation, noting that prior to the arbitrage rule change Massachusetts used "every penny" of its QZAB allocations, but that as of spring 2008 the state had yet to give away over \$13 million, the full amount of the state's 2006 and 2007 allocations. These allocations are due to expire in 2008 and 2009, respectively; meanwhile a \$10-million deal for a Boston charter school is pending and expected to close before the end of 2008. Farrell-Hart of CDE makes a similar point to Chuang, stating that the arbitrage changes mean that QZABs are no longer "as good a deal for investors." She adds that, as of summer 2008, California had \$48.6 million remaining from the \$98 million awarded to the state in QZAB allocations for 2006 and 2007; as in Massachusetts, these allocations also are set to expire in 2008 and 2009.

### *Enabling Direct Loans for Charter School Facilities*

As discussed above, the relatively low-cost finance options that states and Washington, D.C., have made available for charter school facilities has tended to relate to some form of bond financing. Another option for helping charter

schools cover their capital expenses is to offer direct loans of public funds for this purpose. The District is the only jurisdiction interviewed for this project that has a dedicated loan fund for charter school facilities support. Established in 2003, the District's Direct Loan Fund for Public Charter School Improvement program provides flexible loan funds for the purchase, renovation, construction, and maintenance of charter school facilities, whether a school chooses to lease or own its site. As of the close of 2007, the District had obligated over \$14 million in these direct loan funds, with approximately \$12 million more available. According to Liggins from the District's Office of the Deputy Mayor for Planning and Economic Development, schools can receive up to \$2 million in these loan funds at a relatively low interest rate (ranging from 2 to 4 percent over the life of the program thus far).

## Mitigation of Investor Risk

As mentioned in the introduction to this section, even when mechanisms are in place enabling charter schools to issue bonds or to benefit from proceeds generated by tax credits, such as QZABs, many lenders continue to see these education institutions as risky investments. This perception can lead to steep premiums associated with facilities financing in the form of high interest rates or to unwillingness to lend—period.<sup>47</sup> As touched on earlier, among the primary factors eroding investor confidence are charter schools' relatively short operating histories thus far; the potential for cash flow problems (e.g., state aid payments can be delayed; also, schools usually have to sign a multiyear lease, yet, because student aid generally is calculated annually, a school cannot be certain in

advance what level of aid it will receive from year to year); charter schools' inherent risk for nonrenewal or closure; and their lack of taxing authority.<sup>48</sup> To mitigate such concerns, states can make policy aimed at enhancing the creditworthiness of charter schools by providing lenders with some level of backup security. A variety of "credit enhancement" approaches undertaken by states to increase charter schools' capacity to raise private sector capital are discussed below.

### *Including Charter Schools in General Obligation Bonds*

One of the strongest existing forms of credit enhancement for charter schools—but also one of the most rarely used approaches—is when a state or local government includes charter schools in general obligation bonds. Although this credit enhancement approach remains uncommon, two states—California and Colorado—have programs allowing charter schools to benefit from tax-exempt general obligation bond proceeds.

As explained by Katrina Johantgen, executive director of the California School Finance Authority, in 2002, California established the Charter School Facilities Program (CSFP) to provide revenue for the construction or rehabilitation of charter school facilities. In providing state funds, the CSFP offers only half of what a school needs, requiring that the school seek a match, usually in the form of a loan, for the other half. The program itself offers such loans at a relatively low interest rate. CSFP was initially funded with revenue from a large, state-level, voter-approved general obligation bond issue for general education facilities, and it subsequently has received additional revenue with



the passage of two other state ballot propositions.<sup>49</sup> Since its inception, the program has been funded with \$900 million earmarked for charter school facilities.

According to Johantgen, CSFP was modeled after the state's School Facility Program, which is an application-based grant program for traditional public schools. But she cautions that the CSFP is challenging to navigate, especially for schools that do not have an expert with knowledge of facilities or finance readily at hand. Through the CSFP, charter schools that provide site-based instruction (as compared to schools offering distance learning courses) may apply for these bond funds. Those schools deemed by the California School Finance Authority to be financially sound are eligible for state facility funding, with preference given for numerous factors, including whether the school serves a low-income population or operates in an overcrowded district. Projects are granted funds on a per-pupil basis at a level set annually by the State Allocation Board, though they must raise or borrow funding to match state facilities aid.

Yet even in combination with the 50 percent match, program awards almost never fully cover a school's construction costs, according to Caprice Young, president and chief executive officer of the California Charter Schools Association. This means most schools must piece together other funding as well. Because there are also many complications associated with these funds, charters have struggled to use them. To start with, the law is not clear about who has the right to title during construction, which can make it difficult to obtain construction insurance. What is clear, however, is that

once CSFP-funded facilities have been completed, the district in which they are located holds title to them. Without the title to serve as collateral, charter schools have greater difficulty securing supplemental financing from commercial lenders.

In addition, two other major challenges are associated with these funds. First, CSFP funds cannot be used for predevelopment costs, such as site-acquisition studies. Another challenge is that accessing these state funds requires interaction with at least seven state agencies and advisory bodies.<sup>50</sup> Young estimates that the lag time involved in garnering the necessary approvals from these agencies adds roughly three years to the timeline for completing a new facility. The program is structured to reserve the funds awarded to schools for four years, with the possibility of a one-year extension. So CSFP funds are "on hold" during the period when charter schools seek approvals (e.g., construction permits, certifications that sites are free of toxic substances, authorization that space meets standards of adequacy for classroom instruction), according to Barbara Kampmeiner, project management supervisor at California's Office of Public School Construction. Unfortunately, the delays associated with securing the necessary approvals can interfere with the schools' ability to acquire other financing.

The fiscal year 2008–09 budget analysis from California's Legislative Analyst's Office suggests that the bulk of funds appropriated for the CSFP remain unspent. Only about 12 percent of the \$400 million appropriated from propositions passed in 2002 and 2004<sup>51</sup> appeared to have been utilized as of February 2008, and none of the funds from an approved 2006 proposition

had been apportioned at that time. However, Kampmeiert reports that about \$463 million out of the \$500 million in funds appropriated through the 2006 measure were awarded (and thus reserved) for 29 projects as of the end of May 2008. She also points out that her office “wouldn’t necessarily expect the funds to be spent at this time.” Kampmeiert explains that there is still time for many of the projects awarded in prior years that have not yet received their full apportionments to garner the approvals necessary to access the rest of their funds. In fact, she says, the program was designed to allow adequate time for a school to obtain all necessary approvals.<sup>52</sup> According to Kampmeiert, the per-pupil grant amounts that charter schools received under the 2004 proposition were \$5,870 for elementary students, \$6,214 for middle school students, and \$8,116 for high school students.<sup>53</sup> But no matter what the specific funding amounts have been, Kampmeiert notes, the advent of charter schools being allotted portions of general obligation bond issues is itself a significant policy development.

Although at least one Colorado school district included a charter school in a bond election prior to passage of the state’s *Charter School Capital Facilities Financing Act* of 2002, this legislation established as state law a charter school’s ability to submit a capital construction plan to be included in a school district’s general obligation bond issue. Jim Griffin, president of the Colorado League of Charter Schools (League), says that while Colorado districts have the right to reject a charter school’s request to be included, six districts have already included charter schools’ requests in successful bond elections. Table 4 on p. 32, a funding summary

provided by Griffin, shows that the state’s charter schools had received \$55 million of these proceeds as of spring 2008. (In the summer of 2008, Griffin reported that a number of sizeable districts in the metropolitan Denver area were planning to seek voter approval for bond funds in fall 2008 and charter schools intended to seek inclusion in six district bond requests. A follow-up exchange with Griffin after the election revealed that only two districts that sought bond funding on the November ballot had included charter schools in their request, and only one of them had received voter approval.)

Another stipulation of the 2002 legislation, he says, is that when districts reject such proposals from charter operators, the operators may place a separate ballot question for a vote on their school’s behalf. As of spring 2008, five such requests had failed at the ballot box, according to Griffin.

The Colorado League did not initially seek the statutory ability for charter schools to be included in district bond elections. Rather, says Griffin, its goal during the 2002 legislative session was to seek a large influx of grant funds for charter school facilities. It was only after representatives from state and local education agencies argued that charter schools should have to seek voter approval for funding, just as districts do, that the League conceived of the *Charter School Capital Facilities Financing Act*.

### **Allowing Access to Moral Obligation Bonds**

Another credit enhancement option, a step short of including charter schools in general obligation bonds, is to give them access to moral obligation bonds. A moral obligation is a

**Table 4.** Participation of Colorado Charter Schools in District Bond Elections, School Year 1999–2000 to 2006–07

School Year	District	Amount of General Obligation Bond Proceeds Received by Charters (in Millions)	Number of Charter Schools Benefiting From These Proceeds
1999–2000	Eagle County Schools District	\$1.1	1
2002–03	Pueblo School District 60	\$6.2	3
2003–04	Denver Public Schools District	\$19.0	3
2004–05	Jefferson County Public Schools District	\$11.5	10
2005–06	Colorado Springs School District 11	\$7.5	6
2006–07	Boulder Valley School District	\$9.7	4
TOTAL		\$55.0	27

**Source:** A Colorado League of Charter Schools internal funding summary, based on records from supporting work conducted by the League during the 2007–08 school year as part of its Facilities 2010 Initiative.

pledge made by a government entity, which is not legally binding, stating that it will repay the bond debt in the event the borrower defaults. These bonds are commonly issued to finance projects considered to be in the public good, such as hospital construction. For some local and state governments, the appeal of this financing approach is that it allows them to avoid any existing debt limits (e.g., some states are legally prohibited from acquiring debt and, therefore, from issuing general obligation bonds) or to avoid the voter approval process required for general obligation bonds. For charter schools, which do not have access to general obligation bonds, moral obligation bonds offer the next best alternative, even though these bonds tend to be rated lower than general obligation bonds and, therefore, are more expensive for the borrower. Although these bonds are not considered as safe as general obligation bonds, according

to Griffin, if a state legislature, for example, gave an issuer permission to offer the bonds under the state’s “moral obligation,” the legislature would likely honor any request to cover a default, appropriating funds to make good on outstanding bond payments. To do otherwise would invite investor mistrust, making it highly unlikely that anyone in the state could issue moral obligation bonds in the future.

Colorado is the only state thus far to make a moral obligation provision available for charter school financing.<sup>54</sup> The provision, established in 2003, attaches to select bonds the state’s pledge that, in the event of a default, the governor will request that the state legislature appropriate funds to pay debt service. Only bonds rated “investment grade” are eligible to attach Colorado’s moral obligation pledge.<sup>55</sup> The Colorado Educational and Cultural Facilities Authority

(CECFA) accepts financing applications into this moral obligation program based on the representation of a school's investment banker that the school will obtain the required investment grade rating. The CECFA's bond counsel requires evidence of this rating before bonds are issued on behalf of charter schools. As is the case with all moral obligation pledges, the bonds are not legally guaranteed by the state. But in the event of a default, if the state did not make good on the debt, there could be a substantial negative effect on its credit.

All participants in the moral obligation program are required to utilize the intercept mechanism, described below. (Other eligible charter schools that issue bonds may choose whether to have their debt service intercepted.) As of April 2008, Colorado's moral obligation pledge has been attached to over \$317 million in bond financing for 24 charter schools, according to CECFA's Jo Ann Soker, who says that as of spring 2008, there had been no defaults on moral obligation bonds. Griffin indicates that participating charter schools have found the moral obligation provision to be effective in lowering interest rates.

### *Offering Intercept Mechanisms*

A more prevalent state approach to credit enhancement is creation of an intercept mechanism, which allows a state to divert a charter school's per-pupil revenue and transmit it directly to bondholders for debt-service payments. For investors who might worry about not getting payment from a charter school, this is a very straightforward mechanism intended to raise their comfort level when lending to charter schools.<sup>56</sup> Several states have intercept

mechanisms that can be utilized for servicing bonds (and other facilities debt). Respondents from two of those states interviewed for this project, Colorado and Michigan, describe the benefits to charter schools that take advantage of this credit feature.

Colorado's intercept program was initiated for charters in 2003. The state treasurer performs intercepts only for charter schools that receive enough state aid "to cover the entire annual amount of the principal and interest payments" on any bonds issued.<sup>57</sup> This provision ensures that the treasurer is not liable for any additional funds that may be owed but are not being received. According to CECFA's Soker, to date, 54 percent of bond issues for Colorado charter schools have had funds in the intercept program (specifically, 41 charters have used the intercept program, 24 of them as a contingency of their participation in the state's moral obligation program. Some qualifying charter operators opt not to take advantage of the state intercept program because they prefer to have control of their own funds. The Michigan Public Education Facilities Authority (MPEFA) also intercepts state per-pupil aid and makes the payments on bonds for all charter schools issuing bonds through the agency.

Respondents from both states note that the intercept mechanisms give lenders greater confidence that they will receive their promised debt payments, which, in turn, translates into more favorable financing terms for charter schools. MPEFA's Kathy O'Keefe says competitive rates on bonds issued through the agency are available in large part because her organization can intercept state aid. Jim Griffin of the Colorado League of Charter Schools says that using the state's intercept

mechanism helps charter schools enhance their credit ratings because, in part, it assures investors that charter schools will not misuse funds. He likens it to an employer “intercepting” an employee’s paycheck to send his or her mortgage payment directly to the bank holding the employee’s mortgage: “It’s one more step to make the bank feel better about their probability of getting paid. [Using an intercept mechanism] won’t save a charter from going under. There are probably some other things that can still go wrong, but at least it means that the charter won’t spend the money that they need to be sending to the [bond] trustees.”

### *Funding a Debt-service Reserve*

An additional policy alternative for mitigating the risk of investing in charter schools is establishment of a pool of capital that, rather than being loaned out, is maintained as a “reserve,” set aside to satisfy debt service in the event of payment default.<sup>58</sup> Both Michigan and Texas have developed this type of reserve for charter school financing, using grant funds received through the U.S. Department of Education’s Credit Enhancement for Charter School Facilities program (Credit Enhancement). According to state respondents, the programs have helped reduce charter schools’ borrowing costs on bond financing.

In 2007, Michigan Public Education Facilities Authority (MPEFA) received \$6.5 million in these federal Credit Enhancement grant funds, and it has put these monies into a reserve fund that guarantees the bonds it issues to finance charter school facilities.<sup>59</sup> Further funding this reserve is \$5 million in state-appropriated funds, which come with fewer restrictions. The state funds

were first appropriated in 1999, before MPEFA was created, for a loan reserve fund to facilitate capital or operational loans to charter schools. When MPEFA was established, it also received the authority to manage these funds, and it opted to invest the \$5 million and use part of the earnings from the investment to augment the debt-service reserve fund. Initially, it used some of the investment earnings for a short-term cash flow program for charter schools that it also administers. But when the agency received the federal Credit Enhancement grant, Michigan adopted a policy committing all of these earnings to the charter facilities debt-service reserve fund. The reserve is funded for the full life of the bonds it is used to secure (which are typically 20- to 30-year transactions).

Similarly, the Texas Public Finance Authority (TPFA) Charter School Finance Corporation entered into a consortium agreement with the Texas Education Agency (TEA) and the Resource Center for Charter Schools to operate the Texas Credit Enhancement Program (TCEP).<sup>60</sup> TCEP utilizes a \$10 million federal Credit Enhancement grant for a debt-service reserve fund guaranteeing eligible tax-exempt bonds issued on behalf of charter schools for facilities. The TEA also has contributed \$100,000 for this reserve fund. The statutory authorization for the fund was established in 2001 through state legislation,<sup>61</sup> but TCEP was not funded until the TPFA received the federal grant in 2005. In addition, initially, to qualify for the reserve fund, bonds had to be issued through the TPFA, but the statute was amended in 2007 so that it could be used to guarantee any eligible bond issue in the state. As of June 2008, the TCEP supported approximately \$217 million of bonds issued on behalf of charter schools.

## Clarifying Charter Schools' Public Nonprofit Entity Status

Legal clarification—in charter school legislation, or charter school contracts, or both—that charter schools carry all of the powers of a public nonprofit entity is another avenue for enhancing their credit potential.\* States that have such protective language that clarifies charter schools' ability to incorporate as public nonprofits and, therefore, to sue, can help protect schools from any arbitrary and potentially unfair decision by an authorizer (e.g., a politically motivated decision not to renew a school's charter). Validating schools' authority to sue their authorizers also can attract investors to charter schools because it reduces the chance that a charter would be revoked or not renewed without due process.

Colorado also has been a leader in this area through ratification of an amendment that clarifies the public entity status of the state's charter schools and includes language regarding their capacity to sue. Under this amendment, Colorado charter schools have clear authority to enforce their contracts through litigation against their authorizers (the vast majority in Colorado being school districts). For example, if an authorizer were to revoke or not renew a school's charter, the charter school could sue the authorizer. Jim Griffin explains that the underlying intent of these clarifications was to make charter schools more financeable.

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\* Nonprofit entities are agencies, organizations, and institutions given tax-exempt status. These entities may be public or private. Public entities are typically state or local governments or agencies, organizations, or institutions under public supervision.

## Policy Considerations Regarding Ability to Borrow Money for Facilities

Respondents interviewed for this guide shared several suggestions and reflections based on their experience with charter school financing. These may be useful for policymakers.

*Incremental development of charter school finance market.* Two respondents, the Massachusetts Charter Public School Association's Marc Kenen and Jim Griffin of the Colorado League, advise that it takes time for any charter bond market to mature. In their experience, the first step is that some schools must be successful getting in the door with the local private lending sector and securing commercial loans. As this happens, banks begin to understand that the risks associated with lending to charter schools are not as great as they might have imagined. As these lenders develop a level of comfort with charter school financing, they begin to consider these schools as another potential market. Once the market is established, state legislatures are more likely to pass legislation that gives charters access to lower-cost financing options, such as tax-exempt bonds or tax credits.

*Flexible financing options for start-up and smaller charter schools.* As mentioned, the borrowing options for larger, more mature charter schools are better developed than those for start-up and smaller charter schools. To shrink the financing barriers for the newer and smaller schools, Jim Griffin suggests that state policymakers consider developing special funding programs to offset capital needs for charter schools that are not able to benefit from bonds.



## Tax Breaks for Investors Make School Renovation a Reality Neighborhood House Charter School, Boston

The Neighborhood House Charter School (NHCS) sits on three acres of land, overlooking a bay from one of the highest points in Boston. The school’s building was previously used as a nonprofit transitional home for troubled youths, and sat empty for a year before the school purchased it and embarked on an ambitious renovation. NHCS gutted two wings of the facility and built an addition, creating an inviting school setting with plenty of greenery. The total price for the purchase and renovation of this facility was approximately \$20 million.

In Massachusetts, charter schools receive direct cash assistance, but the amount is limited: only about \$850 per pupil (compared to over \$3,000 per pupil in Washington, D.C., for example). This funding is not nearly enough to cover all of NHCS’s facilities costs, but it helps, and this revenue source also makes the school more attractive to investors. In addition to long-term loans and private fund-raising, the school raised \$7.1 million through tax-exempt bonds underwritten by Fleet America (now Bank of America) and approximately \$7 million in federal Qualified Zone Academy Bonds (QZABs)—bonds that offer tax credits to investors. The school will pay back its various debts over the course of 30 years, initially with annual payments of approximately \$450,000 to \$500,000.

The QZABs were critical to financing the NHCS facility. Jug Chokshi, the school’s chief financial officer, says, “If it wasn’t for the QZABs, I don’t know that we would have gone forward with this real estate deal.” At the same time, however, the QZABs also restricted the school’s options for how it could spend the money. Because QZABs cannot be used to finance new construction, the charter school’s operators decided mostly to rebuild the facility they had purchased instead of tearing it down and starting from the ground up. (Funding from other sources was used to finance the new portions of the facility.)

The school had to spend a substantial amount of time and resources to complete the transactions for both the QZABs and the tax-exempt bonds. To help them, the school’s operators relied heavily on an external group called Paradigm Properties for advice throughout the complex financing process and for help with communication among the various parties involved. As with all the school’s financial transactions, the purchase and financing was handled not by the school itself, but by a foundation set up to handle the school’s finances. This arrangement protects any private investments from being forfeited to the state if the school should close for any reason.

NHCS had several advantages that made it a good candidate for the sophisticated forms of financing it pursued. Having opened in 1994, NHCS has a longer track record and history of securing financing than many charter schools. (Tax-exempt bonds and QZABs typically are used by relatively mature charter schools seeking large sums of money.) NHCS also had the benefit of having several school board members with backgrounds in real estate and finance. These members initially sparked the idea to purchase a facility and also had the expertise to support the school through the complex financing process it chose.

### Neighborhood House Charter School: Selected Statistics

Year Opened	Grade Levels	Number of Students	Number of Campuses	Student Ethnicity	Special Education	Free and Reduced-Price Lunch
1994	Pre-K–8	399	1	51% African-American 24% White 17% Hispanic 4% Asian American 2% Native American	11%	77%

**Source:** Untitled document from the Massachusetts Department of Elementary and Secondary Education for the 2007–08 school year.



*Government support of entities involved in charter school finance.* Many jurisdictions, including those featured in this part of the guide on charter school borrowing, offer examples of partnerships and close collaboration among government agencies involved in charter school finance, such as conduit issuers and state departments of education. In addition, the conduit issuers featured in this guide illustrate how enabling a central government agency (or, as in the case of Washington, D.C., a city government) to issue bonds on behalf of charter schools throughout the jurisdiction can help develop this finance market.

In some cases, charter school associations also have developed strong working relationships with government and quasi-public agencies that deepen the support available for charter school facilities. For example, for Massachusetts, Sullivan and Chuang specifically call attention to the benefits of close collaboration between key state agencies involved in charter facility finance, including the charter association, the Massachusetts Department of Elementary and Secondary Education, and MassDevelopment. Sullivan suggests that this collaboration may be unique in the country and says that it has been “very helpful” because the association and the department identify the needs within the marketplace and MassDevelopment helps to find solutions. In addition, Chuang says that, informally, this collaboration, involving regular interaction among the various players, has made communication and processes smoother, enabling the three agencies to coordinate.

*Efficiencies through government-supported technical assistance and streamlining.* Since facilities finance is not typically among the core competencies of charter school operators, they require significant technical assistance to understand the options, particularly in the bond arena—both tax-exempt and QZABs. Typically, schools hire financial advisors and consultants who can help them learn about and navigate financing deals. However, if government agencies could provide this expertise free of charge, charter schools could save time and money.

Washington, D.C.’s William Liggins highlights examples of how the Office of the Deputy Mayor for Planning and Economic Development (ODMPED) provides these benefits to charter schools seeking bond financing. According to Liggins, ODMPED holds many seminars to teach charter schools about the available financing options, and its staff is well versed in and shares information about the associated processes and relevant tax regulations. He emphasizes that streamlining the processes involved in securing bond financing through ODMPED to make them as efficient as possible and being as transparent and open as possible have been critical. ODMPED strives to have a user-friendly process in which all of the details and timing related to the application can be clearly explained. This helps ensure that schools complete all of their due-diligence related to leases, deeds, and any type of zoning issues. This streamlining also results in resource savings for charter schools (i.e., money and time).





## PART III

# District Provision of School Facilities

*This third policy approach focuses on making publicly financed space available for charter schools, on the theory that, like all public schools, charter schools deserve access to facilities that have been developed with taxpayers' money. Some jurisdictions have taken this tack by encouraging local school districts to provide facilities to charter schools at low or no cost. A 2005 study by the Local Initiatives Support Corporation (LISC) found that of the 41 jurisdictions with charter school legislation, 26 permit the use of district facilities for charter schools.<sup>62</sup> However, as the study notes, this finding is misleading: In many of these instances, technical authorization of such use has not translated into actual use, while in others, some charter schools are housed in district space but there are no specific laws or guidelines specifying such use.<sup>63</sup> No national data are available, but anecdotal information suggests that relatively few charter schools operate on district property.<sup>64</sup>*

Reluctance on the part of many school districts may be the foremost obstacle to making this a meaningful option. Since per-pupil instructional aid typically follows students to charter schools, any resistance on the part of districts is likely rooted in their perception that charter schools are draining funding from the district budget. In addition, some districts view the oversight required to administer the provision of space to charter schools as an additional burden for district personnel, one that might well take time away from their other duties. Nevertheless, this option has clear appeal for charter schools, which, given the option, would much prefer having free or at least affordable access to space that was actually designed for school use, as opposed to having to pay to reconfigure a former shopping mall, office, church, temple,

storefront, or any other building that was originally designed as something other than a school.<sup>65</sup> This assumes, of course, that the district space is in decent condition, since having to renovate facilities that are in poor condition could easily undercut what might otherwise be significant cost savings.

### Models of Districts Providing School Facilities

Among those places with charter school legislation, California, Colorado, and Washington, D.C. (the District), appear to have significant numbers of charter schools housed in district space, according to the advisory group for this guide. Taken together, these three jurisdictions

illustrate variation in how policymakers have structured this policy approach. Some of the common questions they have had to consider in developing their policies are whether districts should be required or merely encouraged to provide facilities for charter schools; whether any requirement to provide space should only hold true if a district has excess space; and whether districts should be allowed to charge rent.

### ***Encouraging or Requiring: Various Approaches to Access to Facilities***

Both California and the District have strongly worded laws that, under certain conditions, require school districts to provide facilities or give facilities preference to charter schools operating within their jurisdictions. In California, Proposition 39, approved by state voters in 2000, requires districts to provide any charter school that serves a minimum of 80 district students with facilities that are “sufficient” in size for the school’s enrollment and “reasonably equivalent” to the buildings or classrooms of students attending other public schools in the district.<sup>66</sup> The rationale underlying the proposition is that districts have already received state funding to build facilities for these students. Even if a district has no excess space available, Proposition 39 requires that the district provide charter schools with facilities unless it would have to “use unrestricted general fund revenues to rent, buy, or lease facilities for charter schools.”<sup>67</sup> The measure also requires that these facilities remain the property of the district and that they be “contiguous, furnished, and equipped.” This means that a charter school must be located on a single site if possible; that when it is necessary to put a school on multiple sites, the sites be as near to one another as possible; and that

the facilities given to a charter school contain all of the furniture and equipment necessary for classroom instruction.<sup>68</sup> Additionally, districts are obligated to make reasonable efforts to provide facilities that are near where a charter school wishes to locate and, once a charter school has been located in district facilities, a district is not to move it unnecessarily.<sup>69</sup> Caprice Young says there are no statewide data on how many California charter schools are housed in district facilities, but she estimates that as many as 40 percent of the state’s charter schools are located in district-owned buildings.

Although the original charter school law in the District (i.e., the *School Reform Act of 1995*) gave preference to charters for acquiring excess space in the facilities inventory of District of Columbia Public Schools (DCPS), the law did not define what it meant by “preference.” This language has been strengthened twice, first by the D.C. Council to read “first preference,” and then by the U.S. Congress to read “right of first offer.” The current law requires that charter schools be given first opportunity to bid to lease, at below-market rates, either empty DCPS school buildings or unused space within a DCPS school building that is not operating at full capacity. As the *School Reform Act* has been modified over the years to reflect changing views about charter school facilities support, DCPS policy has evolved—and continues to evolve—in response.

Overall, according to Robert Cane, executive director of FOCUS, the Congressional dictate that charter schools should have the first-offer right to bid on DCPS’s surplus space has been “consistently ignored” and it has been a major struggle for charter school operators to access

unused district facilities. He acknowledges that through ongoing advocacy efforts, FOCUS has “managed to scrape together some buildings ... [and] for a couple hundred charter school students here and there, on a short-term basis, we have been able to colocate” by occupying unused portions of DCPS buildings. As of spring 2008, he says, about 20 percent of the District’s charter schools were housed in 14 former DCPS school buildings. One building had been divided up and leased to three charter schools, and charter schools had either obtained a long-term lease or purchased the other buildings.

In contrast with Washington, D.C.’s law, California’s law requires districts to provide charter schools with facilities whether or not districts have surplus space.<sup>70</sup> Yet in neither place, according to respondents interviewed for this guide who are familiar with the laws of these two entities, have charter schools gained easy access to available district facilities. While no records document charter schools’ use of district facilities in these two jurisdictions, respondents estimate that the majority of charter schools in both places have yet to receive any district space. Assuming these estimates are accurate, the reasons behind the numbers could speak more to actual space availability than to any unwillingness on the part of districts. But anecdotal information provided by those interviewed for this guide suggests that charter schools’ efforts to access district space have provoked considerable conflict among charter schools, districts, and interested stakeholders.

In California, Caprice Young says, litigation has typically been necessary to force compliance; very few districts have willingly followed the dictates of Proposition 39. There have been

at least eight lawsuits brought by or on behalf of charter schools to enforce its requirements, and, according to Young, court rulings have consistently favored charter schools, reinforcing and strengthening the regulations of Proposition 39 over time.<sup>71</sup> Young explains that the courts have established that districts must provide charter schools with equitable space and have specified a clear definition of what this means. For example, the 2005 *Ridgecrest Charter School v. Sierra Sands Unified School District* decision stipulates that simply providing students with seats is not enough—districts must make an effort to provide charter schools with contiguous space (e.g., located on a single site when possible and, when not, in sites near one another).

Colorado operates under a different policy model that does not require districts to provide space for charters. Rather, it prohibits districts from charging rent for space (including land) deemed “otherwise available.”<sup>72,73</sup> Thus, as a practical matter, there is no monetary incentive for a district to give surplus space to someone other than a charter school. If a district has approved a charter school and the district also has an empty, usable building, it is hard to make the case that the charter school should not be entitled to that facility, says Jim Griffin, president of the Colorado League of Charter Schools (League). Yet, by Griffin’s own estimate, most of the state’s charter schools are authorized by local districts (approximately 129 of 131 charter schools), most Colorado districts have surplus space, and only about 28 percent of the state’s charter schools have benefited from access to district facilities or land.

While district provision of facilities has not proved to be as widespread a solution for Colorado charter schools as some might wish, Griffin says, it has not been as contentious an issue as in other parts of the country. Some Colorado districts have objected to a charter school taking over one of their buildings on the basis that the district was using the space for storage, that it had plans to use it in the future, or that the building was unsafe. But the number of lawsuits in response to such decisions has been nothing compared to the degree of litigation in California, for example. In Griffin's view, Colorado was wise to take a less prescriptive approach because local circumstances vary and a "statewide, uniformly applicable prescription can cause unintended consequences," such as district resistance. Rather than forcing districts to provide space, he suggests, it is better to allow them to use their own judgment to determine whether an agreement makes sense and, if so, to shape it.

### ***Making It Free or Charging a Fee: Various Approaches to District Facilities Costs***

Encouraging or requiring districts to offer some of their space to charter schools is one thing. Deciding whether and what a district can charge for that access is a related but separate policy issue that must be considered. Most of the district housing arrangements worked out for charter schools in Colorado have been relatively free of conflict, according to Griffin. Some charter schools, he says, have worked with a district to find creative ways around the letter of the law as it relates to the prohibition against districts charging rent. For instance, charter schools sometimes agree to pay "upkeep and maintenance fees" for district property. Griffin points to other

instances in which a district has paid to build a facility intended to house a charter school and, because this new space is defined as not having been "available" prior to construction, some sort of payment has been negotiated with the charter school. He asserts that charter schools that have successfully negotiated such arrangements consider the costs reasonable.

The issue of cost for district facilities is handled differently in the other two jurisdictions profiled in this section, the District and California. In the District, lease agreements between charter schools and DCPS are individually negotiated. According to Stefan Huh, director of the Office of Public Charter School Financing and Support in the D.C. Office of the State Superintendent of Education, these arrangements are supposed to take into account some estimate of market value lease rates, while still offering charter schools a lease *below* market value.

In California, policy related to whether districts are permitted to charge charter schools for occupying district facilities is complex. Proposition 39 prohibits districts from charging rent to a charter school if the district property in question was purchased with taxpayer-backed bond funds earmarked for facilities. However, a facility fee may be computed according to a specified formula that calculates a charter school's share of any general discretionary funds that a district has to expend on a facility.<sup>74</sup>

Caprice Young, of the California Charter Schools Association, sheds light on a related practice that she says is common among the few districts that have agreed to house charter schools under Proposition 39: negotiating an agreement with a charter school that enables the district

to charge the school fees similar to rent. Young suggests that charter schools are willing to pay such agreed-upon fees, first, because the district fees are usually less expensive than commercial lease rates would be and, second, because the schools have difficulty locating an appropriate facility for a school. Even so, she believes, imposing such charges are “fundamentally at odds with the main principle of Proposition 39—that charter students are public school students.” As taxpayers, charter school parents already contribute to financial support for their district’s school facilities and, for that reason, Young argues, charter school students have an equal right to use those public assets. To her, it is inequitable for districts to charge charter schools any more than what they would charge other district students to attend school in a district facility, which, she points out, is nothing.

## Additional Barriers to Access to Facilities

On top of the barriers to district space already mentioned, there are others. Among them are intricacies of the bureaucratic processes involved, inadequacies in the condition or location of available facilities, stalemates regarding the terms of agreements between districts and schools, and lack of effective legal tools to enforce requirements.<sup>75</sup> In California, a serious obstacle is the lack of punitive measure in the law for districts that do not abide by required timelines—an issue that has been described as the “Achilles’ heel of Proposition 39.”<sup>76</sup> In Washington, D.C., one of the most common sticking points has been the definition of a vacant facility.<sup>77</sup> In some cases, DCPS’s claims that space is needed for other purposes may be legitimate,

and in other cases it is not clear. Such examples illustrate the implementation challenges related to district provision of facilities for charter schools.

## Policy Considerations Regarding Provision of Facilities

Respondents to interviews conducted for this guide shared several suggestions for improving current laws and regulations on district provision of facilities to charter schools, as well as reflections on such policies enacted to date. These may be useful for policymakers to consider.

*Consider implementation challenges of mandates.* How to enforce mandates related to districts providing facilities for charter schools is an important policy consideration. Caprice Young maintains that, when it comes to asserting that charter schools have the same right to facilities as traditional public schools, California is ahead of the curve, having put it on the public record via Proposition 39 vote in 2000. Enforcing this right is another issue, however. If the law were enforced, she maintains, 100 percent of the state’s charter schools would be located in district facilities, unless, for some reason, they chose not to be. It also has been challenging to implement the first-offer right to bid on excess DCPS facilities, even though this right technically has been granted to Washington, D.C., charter schools.

*Emphasize equity concerns.* Young advises that efforts to inform policymakers of the need to provide charter schools with facilities should start with the premise of equity—that charter schools are public schools and, thus, their



## Legislation Does Not Guarantee Smooth Implementation Rocklin Academy, Rocklin, Calif.

In California, Proposition 39 requires school districts to provide charter schools with facilities that are sufficient in size and reasonably equivalent to other public schools. Still, charter schools' facility requirements frequently do not match what districts have or want to offer. Opened in 2001, Rocklin Academy was one of the first charter schools to use Proposition 39 to obtain district facilities and, like many other schools, it ran into substantial obstacles along the way.

Rocklin Academy originally planned to open as a K–3 school, but had to change its grade configuration when the local district, Rocklin Unified School District (RUSD), gave it space in a middle school that was not age-appropriate for younger students. To utilize the facility it was given, Rocklin Academy changed its plans, opening instead with students in grades 3–6, with plans to add grades over time. Even so, Rocklin Academy paid in excess of \$100,000 for reconstruction and changes to portable buildings, including payment for administrative offices and bathrooms.

After two years, the RUSD moved Rocklin Academy. The charter school had been growing into a K–8 school, but RUSD moved it to a relatively new and underutilized K–6 school site that had available classroom space. Here again, the grade span of the available facility did not match the grade span planned by the charter school. To use the space it was given, Rocklin Academy had to disenroll its seventh-grade students and forestall its planned eighth-grade expansion—a setback that left the school's administrators, families, and other stakeholders deeply frustrated.

After a protracted period of negotiation, in order to avoid litigation, both sides consented to a 10-year agreement. Rocklin Academy now has space in two district facilities, each of which will house a K–6 program, since neither space had enough room to accommodate the entire student body of the charter school. The agreement also allows Rocklin's operators to apply later for space to serve students in grades 7–12. As part of its agreement with the district, Rocklin Academy paid the costs of moving and shares the ongoing costs of maintenance, utilities, and janitorial costs at the two sites. In total, Rocklin Academy is using roughly 10 percent of its revenue stream to pay for use of district facilities, or approximately \$550 per student. David Patterson, founder and executive director of Rocklin Academy, considers both facilities to be "excellent" and feels that both the school and the district have worked hard to reach an agreement that is "fair in terms of cost and services."

Echoing the views expressed by other charter advocates in California, Patterson believes that Proposition 39 is "terribly underutilized." One problem, he notes, is that many people—both charter school administrators and district personnel—are unfamiliar with the intricacies of its rules and regulations. Patterson's advice to other charter school operators seeking district facilities is to learn thoroughly the relevant laws and regulations and to plan on committing substantial time to educating district counterparts on those topics.

### Rocklin Academy: Selected Statistics

Year Opened	Grade Levels	Number of Students	Number of Campuses	Student Ethnicity	Special Education	Free and Reduced-Price Lunch
2001	K–6	362	2	67% White 10% Asian American 8% Hispanic	4%	2%

**Source:** DataQuest system, California Department of Education for the 2006–07 school year.

students have the same right to a safe, appropriate facility as any other public school student. From her standpoint, this position emphasizing resource inequities is the most effective legal strategy and could, potentially, lead to civil rights litigation. Robert Cane, of FOCUS, puts it this way: “Until people and politicians think of charter schools as being public schools—*really* being public schools, instead of just ‘competition for the public schools’—I don’t think things are going to get any better.” To increase public awareness on this issue, FOCUS has adopted the strategy of bringing charter school parents and students to public meetings to talk about how the facilities challenge affects them. In essence, Cane says, FOCUS has created a public relations campaign “trying to get people to understand that there is a good reason for equity.”

*Call attention to economic interests.* Another tack being used by FOCUS is to convince the city government (i.e., the District) that public money is being wasted when vacant DCPS facilities are not offered to charter schools. Their argument, Cane explains, is that the city must expend funds in the per-pupil facilities allowance that has been granted to charter schools and that charter schools, in turn, often have little choice but to use those funds to acquire commercial real estate that, as a result, becomes tax-exempt. Were charter schools instead able to make lease payments to the District, the commercial property would likely continue to yield tax payments to the city. In addition, Young makes the argument that the notion of a school district *owning* its school buildings is a fallacy; in reality, she says, because public school buildings are financed with tax dollars, they belong to the community.





# Conclusion

As noted in the introduction to this guide, paying for appropriate facilities has been a persistent challenge for charter schools. Many schools have had little choice but to cover their capital costs by diverting funds from already stretched operating budgets, thus eating into monies intended for instruction. Most charter schools also engage in complicated searches for facilities funding from a variety of sources.

Many jurisdictions have been dedicating substantial effort to easing this burden, as evidenced by the creative and sophisticated policy interventions profiled in this guide. For policymakers and charter school stakeholders interested in implementing or adding to the array of models presented here, it may be helpful to consider the following.

- ***Context is key.*** In thinking about what strategies might be most sensible for a particular jurisdiction, start by assessing available resources (including money and space) and identifying key change agents, that is, those in different branches of government who have the political will and capacity to promote or enact new strategies. Also consider what types of support or expertise are needed to ease and optimize implementation of any new form of assistance for charter schools' facilities.

Different circumstances suggest different approaches. For example, in times when state economies are strapped, opening up or broadening charter schools' access to tax-exempt bonds and tax credits like the Qualified Zone Academy Bonds (QZABs) may be more realistic than introducing new charter school facilities grant programs (or making

major increases to existing programs). Similarly, introducing policies that encourage districts to provide facilities to charter schools may be more effective in areas facing declining enrollment.

- ***Policy remedies are evolving and can be interdependent.*** The whole charter school movement has developed incrementally, with growing interest and acceptance over the years. Similarly, developing policy solutions to the charter facilities dilemma appears to be a gradual process. For example, the experiences of many of the sites profiled in this guide suggest that charter school financing markets appear to take time to develop. But as more deals are secured, with few if any defaults, investors gain confidence, which, in turn, promotes further growth.

Sometimes development in one area of support leads naturally to progress in another. For instance, the stable source of revenue provided by even relatively low per-pupil facilities aid grants can provide the security that lenders need in order to feel comfortable investing. Similarly, maturation of a traditional lending market for charter school facilities may encourage a bond market to emerge in this arena.

- ***The current environment presents questions about the extent to which charter schools should be in the real estate business.*** From a policy standpoint, two fundamental and competing issues are whether facilities ownership is a good idea for charter schools and whether charter operators should be freed from the burden of finding suitable facilities. Overall, the current climate of funding and financing for charter schools provides market-based incentives for school operators to be efficient in their facility decisions.

On the other hand, one can argue that as public schools, charter schools should be provided the same resources (e.g., existing public facilities or land, tax, or bond revenues) in the same way that these resources are offered to other public schools. There are no simple answers, as such policy judgments weigh whether charter schools should be brought into the fold of the traditional district system or whether there should be a separate system for the charter sector. Some argue that, just as charter schools pursue innovative approaches to instructional programs or school governance, they also should pursue innovative models of facilities financing, pursuing broader goals, such as creating links with community resources, holding down overall facilities costs, and conserving energy. A potential intermediate approach could involve a system that puts charter schools in direct relationship with the state, rather than districts, for their financing arrangements.

- *Challenges remain and innovative solutions are needed.* Even if all of the strategies mentioned in this guide were widely adopted and perfectly implemented, some charter schools would still struggle to find appropriate facilities. For example, some may be well positioned to take advantage of exemplary policies that make financing more affordable, but be unable to locate suitable space. Another vexing challenge is that newer and less well-heeled charter schools often do not meet the requisite credit criteria to access lower-cost financing options. Parents considering charter schools need assurance that there will be a safe and appropriate setting for their children to learn—and many

want to know where a school is going to be located before they are willing to sign up their children. Therefore, policymakers and charter school stakeholders who want to foster the continued growth of this sector need to continue to think beyond the models that are presented in this book and look, especially, at how to design options that support schools in the start-up phase.

- *Policy decisions touch on equity and cost-effectiveness.* The underlying driver for policymakers as they examine all options and make their decisions will always be the need to ensure that as much money and as many resources as possible are going where they are most needed—the classroom. After all, the lack of available funding and the ensuing effort that charter school operators expend on finding and funding facilities means that resources are diverted from teaching and learning. Furthermore, given that charter schools have no tax base, grappling with the facilities dilemma presents an opportunity to pioneer policies that disentangle school funding from local prosperity, which could, in turn, have ramifications for public education in general. Keeping in mind that many charter schools serve low-income student populations, the goal of introducing more equitable approaches is particularly salient.

By considering the models presented in this guide, adapting them to local contexts, and generating new ones, states across the nation can lay the groundwork for offering all public school students the facilities needed to reach their education goals.



## APPENDIX A

# Research Methodology

The research approach used to develop this guide is a combination of case study methodology and benchmarking of “best practices.” Used in businesses worldwide as they seek to continuously improve their operations, benchmarking has been applied more recently to education. Benchmarking is a structured, efficient process that targets key operations and identifies promising practices, defined in comparison to traditional practice or previous practice at the selected sites and quantified, when possible, with local outcome data. The methodology used here is further explained in a background document,<sup>78</sup> which lays out the justification for identifying promising practices based on four sources of rigor in the approach:

- Theory and research base;
- Expert review;
- Site evidence of effectiveness; and
- Systematic field research and cross-site analysis.

The steps of the research process were: defining a study scope, seeking input from experts to refine the scope and inform site selection criteria, screening potential sites, selecting sites to study, collecting and analyzing data to write case reports, and writing a user-friendly guide.

### Study Framework and Data Collection

A conceptual framework was developed to guide all aspects of the study. After examining the research on issues related to charter school facilities funding and finance, a study scope was developed and refined with input from the project’s expert advisory group. Although the conceptual framework was later collapsed to include only three categories, it initially included four major categories of state-level charter school facilities assistance: direct cash assistance for facilities; ability to borrow money for facilities, including participation in tax-exempt bonds; participation of charter schools in Qualified Zone Academy Bonds (QZABs); and mandated district provision of facilities.

The third category, related to QZABs, was later integrated as a subset of the second one, and the fourth category was broadened to include district provision of facilities to charter schools irrespective of whether it is mandated or not. Therefore, the final three categories of focus were

1. Direct cash assistance for facilities;
2. Ability to borrow money; and
3. District provision of school facilities.

Semi-structured interviews, which involve posing a common set of questions with some flexibility for the interviewer to probe based on each interviewee's responses and the context of their particular jurisdiction, were conducted by phone with state policymakers and key staff from state-level charter school associations and networks in each of the selected case study sites. Across the selected states, 21 interviews were conducted with 27 respondents. A wide range of state representatives was interviewed, including staff of state charter associations and resource centers, staff of public conduits issuing bonds on behalf of charter schools, financial experts within state departments, and staff working in charter offices within state departments of education. Key interviews were digitally recorded to ensure accuracy in capturing quotations.

Once a respondent agreed to an interview time, the research team e-mailed a list of topics to be discussed so that he or she could review the topics prior to the interview. This step provided the respondents the opportunity to gather information for questions for which they might not readily have answers. In addition, the research team e-mailed a fact sheet on the state that included relevant data from the *2007 Charter School Facility Finance Landscape* report by Local Initiatives Support Corporation (LISC). This report provides a listing of the financing options available for charter facilities nationally, and includes descriptions of many of the state-level programs featured in this guide. At the beginning of each interview, the research team asked the respondent whether the profile represented on the fact sheet seemed accurate. The team then proceeded with the remainder of the interview questions developed for this study.

These questions were tailored to the particular form of assistance and to the specifics of policies in the state or jurisdiction. In cases where a respondent was unable to respond to a question, the interviewer would clarify the question by posing it in a different way or using additional probes. If the respondent was still uncertain, the interviewer then asked him or her to refer the research team to another contact that would be better able to speak to the issue. As necessary, interviews also were conducted in parts. In some cases, the research team received an initial response, consulted with the internal team or advisors for clarification, and then asked additional questions to obtain further information via e-mail and phone follow-up.

The research team also contacted a small number of charter school operators suggested by state informants due to the operators' savvy in implementing the various forms of facilities assistance policies profiled in this guide. These schools are featured in this guide to give a fuller picture of how the abstract state policies and programs described can function most effectively in practice.

## Site Selection Process

The first step in selecting states was to identify which states have policies and programs that fall into the four major categories of state-level charter school facilities assistance. A matrix of the four types of charter school facilities assistance by state was created using data from LISC's *2007 Charter School Facility Finance Landscape* study and an online database of state policy related to charter school facilities finance developed by the Education Commission of the States in partnership with the National Alliance for Public Charter Schools.



This initial list included approximately 95 policies and programs that fall into the four categories, which are in place in 37 different states and Washington, D.C. This matrix summarizing state policies across the four categories was shared with the advisory group on Feb. 5, 2008, at the U.S. Department of Education, Office of Innovation and Improvement, to solicit further recommendations.

The research team asked advisors to consider and discuss components of exemplary state policy and practice within each of the conceptual framework's four types of assistance. Across these categories, advisors provided guidance on what constitutes evidence of such policy and practice and how states that are most effectively implementing policies intended to help charters meet their facilities needs could be identified. Based on this discussion, the research team summarized the advisory group's recommended guidelines for selecting exemplary forms of state-level charter facilities assistance (see below).

Based on the recommendations from the advisory group, the initial list of 37 states was narrowed to ten states known or thought to potentially have exemplary policy or practice in at least one of the four categories. The group recommended that three of the states known to have the most exemplary and exhaustive charter school facilities assistance policies be selected for the study, and suggested an additional seven states as candidates for further screening through interviews. One state was dropped when the screening interviews revealed that the strategies of interest had not yet been implemented to the degree advisors had thought.

## Selection Considerations

In the aggregate, the states selected for this guide: 1) demonstrated the most intensive levels of assistance and 2) effectively implemented practices in existence to date across the nation. During the February 2008 advisory group meeting, the following characteristics of strong policies (by category) were identified as considerations for site selection. As noted earlier in the methodology, the four categories of assistance described below were collapsed prior to data collection into three primary categories (with the third becoming a subset of the second). The fourth category also was broadened to include district provision of facilities to charter schools whether mandated or not.

### *Characteristics of Policies That the Report's Advisory Group Considers Most Facilitative*

#### **Policy Category 1: Direct cash assistance available for charter school facilities**

- Per-pupil expenditure for facilities is high enough to adequately cover loan or lease expenses (based on current levels of such assistance offered across the nation, a minimum threshold at or around \$1,000 is considered exemplary).
- Total facilities aid per pupil is not a flat allocation (i.e., a constant appropriation divided by the number of students, where the denominator changes from year to year but the appropriation does not increase), but rather
  - adjusts annually to accommodate growth in student enrollment (i.e., a stable source per pupil); and
  - is pegged to local real estate market (e.g., percentage of lease rather than a capped amount).

- All charter schools (start-up and established) have access to the facilities aid.
- Eligible use for the facilities aid is flexible.

### **Policy Category 2: Ability to borrow money within the state**

- State serves as issuer of tax-exempt bonds that finance charter facilities, allows schools to issue their own bonds, or allows them to develop arrangements with small or local issuers that offer additional tax benefits.
- State offers loan programs for charters or allows them to access existing programs for traditional schools at low interest cost.
- States offer credit enhancement instruments that fully or partially guarantee charter school facilities debt. Forms include:
  - Offering a moral obligation on charter school bonds, meaning that issuers have the right to request that states (or cities) appropriate funds to make good on defaulting bonds;
  - Offering general obligation bonds that are backed by the full faith and credit of a government entity; and
  - Providing an intercept mechanism so that the state funding can be captured by lenders in the event that there is a loan default.
- States could give grants to intermediaries (e.g., community development finance institutions), which could, in turn, offer charters loans as well as organizational capacity on real estate or finance; or similar to the federal model demonstrated by grants made to intermediaries by the U.S. Department of Education through the Credit Enhancement for Charter School Facilities Program, states could give grants to intermediaries which could, in turn, use those funds to leverage private funds to offer charter schools loans

as well as organizational capacity and other technical assistance on real estate/finance.

### **Policy Category 3: Participation of charter schools in Qualified Zone Academy Bonds**

- The U.S. Department of Treasury gives state education agencies authority to determine how to distribute their QZAB tax credit allocations to high-poverty schools. State guidelines can therefore help charters gain access to QZABs by making them eligible or giving them priority for these allocations.
- Private partners advocate on behalf of charters to help them gain access to QZABs.

### **Policy Category 4: Mandated provision of district facilities to charter schools**

- Law requires districts to offer vacant facilities to charters at no cost, low cost, or a negotiated rate.
- Proactive local leadership is often important to make it happen.
- States with lots of charters (in percentage terms) housed in district facilities are farthest along in this category.

## **Selection of Respondents for Phone Interviews**

The report advisors also identified individuals in key roles in each state that the research team should contact to determine the status of promising policies and how they were being implemented. This list was expanded when initial contacts identified others who should be included to get a more complete picture of charter facilities financing in the state. The complete list of those interviewed for this guide is found in table A1.

**Table A1.** Respondents\* Interviewed for This Guide

<p><b>Arizona</b></p> <p>Michele Diamond, Financial Consultant, Arizona Charter Schools Association</p> <p>Jay Kaprosy, formerly Legislative Liaison, Arizona Department of Education and now assisting Arizona Charter Schools Association with government relations</p> <p>Steven Race, Chief Financial Officer, Arizona Department of Education</p> <p>Eileen Sigmund, Chief Executive Officer, Arizona Charter Schools Association</p> <p><b>California</b></p> <p>Carol Barkley, Charter Schools Division Director, California Department of Education</p> <p>Shannon Farrell-Hart, education fiscal services consultant in the California Department of Education's School Facilities Planning Division</p> <p>Gary Geeting, former Charter Schools Division Interim Director, California Department of Education</p> <p>Katrina Johantgen, Executive Director, California School Finance Authority</p> <p>Barbara Kampmeiner, Project Management Supervisor, California Office of Public School Construction</p> <p>Adam Miller, Vice President of Finance and Member Services, California Charter Schools Association</p> <p>David Patterson, founder and Executive Director, Rocklin Academy</p> <p>Caprice Young, President and Chief Executive Officer, California Charter Schools Association</p> <p><b>Colorado</b></p> <p>Bill Dougherty, financial advisor to Colorado Educational and Cultural Facilities Authority</p> <p>Jim Griffin, President, Colorado League of Charter Schools</p> <p>Clare Jozwiak, Accountant, Reporting and Analysis Division, Colorado State Treasury</p> <p>Jo Ann Soker, Executive Director, Colorado Educational and Cultural Facilities Authority</p> <p><b>Massachusetts</b></p> <p>Jug Chokshi, Chief Financial Officer, Neighborhood House Charter School</p> <p>Cliff Chuang, Coordinator of Charter School Research and Finance, Massachusetts Department of Elementary and Secondary Education</p>	<p>Marc Kenen, Executive Director, Massachusetts Charter Public School Association</p> <p>Rebecca Sullivan, First Vice President, Massachusetts Development Finance Agency (MassDevelopment)</p> <p><b>Michigan</b></p> <p>Andy DeYoung, Department Analyst, Office of Grants Coordination and School Support, Michigan Department of Education</p> <p>Kathleen O'Keefe, Financial Manager, Michigan Public Educational Facilities Authority</p> <p>Dan Quisenberry, President, Michigan Association of Public School Academies</p> <p><b>Minnesota</b></p> <p>Norman Chaffee, independent consultant on charter school facility issues, formerly with Minnesota Department of Education and the Minnesota Association of Charter Schools</p> <p>Jon Schroeder, cofounder and former Director, Charter Friends National Network, now Senior Associate, Education Evolving</p> <p><b>New Mexico</b></p> <p>Lisa Grover, Executive Director, New Mexico Coalition for Charter Schools</p> <p><b>Texas</b></p> <p>Kim Edwards, Executive Director, Texas Public Finance Authority</p> <p>Katie Howell, Executive Director, Resource Center for Charter Schools</p> <p>Mary Perry, Charter Schools Division Director, Texas Education Agency</p> <p>Judith Porras, General Counsel, Texas Public Finance Authority</p> <p><b>Washington, D.C.</b></p> <p>Robert Cane, Executive Director, Friends of Choice in Urban Schools (FOCUS)</p> <p>Sam Gaillard, CFO, Friendship Public Charter Schools Inc.</p> <p>Stefan Huh, Director, Office of Public Charter School Financing and Support, D.C. Office of the State Superintendent of Education</p> <p>Joe Keeney, CEO and founder, 4th Sector Solutions Inc.</p> <p>William A. Liggins, Director, D.C. Revenue Bond Program, Office of the Deputy Mayor for Planning and Economic Development</p>
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\* Interview respondents were selected initially based on the recommendations of the external advisory group. This list was expanded when initial contacts suggested others who should be interviewed in order to get a more complete picture of charter facilities financing in the state.

## Analysis and Reporting

A research report, organized by the states and jurisdiction (Washington, D.C.) interviewed, was written to document the study process and to provide an analytic report of the data obtained in the interviews. The interview data summarized in these reports were analyzed thematically within each of the categories established through the conceptual framework for this project. This analysis appears in parts I, II, and III of this guide.

To assure the validity of the information, researchers triangulated across multiple sources. The main source of current information about policy implementation was knowledgeable individuals in each state. When possible, sources were sought across different agencies, for example, the state education agency and the charter schools organization. Multiple interviews were conducted in each state. Public documents provided a third major source of triangulation.

Drafts were reviewed by the states to confirm that the research team accurately reported the information given to them. The expert advisors also provided ongoing review of drafts to screen for information that seemed inconsistent with their knowledge of the current state of matters in a state and nationally. If reviewers raised questions, then researchers: a) checked

back with the original source to clarify any mistakes in understanding, b) requested any additional written documentation that is publicly available, and c) sought additional sources of information, such as other experts in the state or individuals in a position to know about the specific form of assistance.

This descriptive research process suggests promising practices, including ways to do things that other educators have found helpful and lessons they have learned, as well as practical “on-the-ground” examples. This is not the kind of experimental research that can yield valid causal claims about what works. Readers should judge for themselves the merits of these policies and practices. Also, readers should understand that these descriptions do not constitute an endorsement of specific practices or products.

## Using This Guide

Ultimately, readers of this guide will need to select, adapt, and implement policies and practices that meet their individual needs and contexts. States coming together in learning communities can use the ideas and practices from these sites as a springboard for their own action research. In this way, a pool of promising practices will grow, and educators can support each other in implementation and learning.



## APPENDIX B

# Statutes Pertaining to State-level Funding, Finance, and Provision of Charter School Facilities

*This guide examines three primary, state-driven policy approaches to mitigating charter schools' facilities needs by easing operators' access to funding, affordable financing, or publicly financed space:*

*Direct cash assistance for facilities*, that is, providing a dedicated funding stream in the form of a per-pupil allocation or other grant program funds specifically directed to support charter school facilities;

*Ability to borrow money for facilities*, that is, helping charter school operators obtain affordable capital to buy, lease, or upgrade their facilities; and

*District provision of facilities*, that is, encouraging or mandating districts to provide charter schools with facilities.

Table B1 provides Web links for the authorizing statute for each facilities assistance program discussed in the body of this report and for related policies. The table is organized by jurisdiction and, within each jurisdiction, by program, with the type of policy approach it represents in parentheses.

**Table B1.** Web Links for Statutes Pertaining to Selected Facilities Assistance Programs and Related Policies, by Jurisdiction and by Policy Approach

Name of Jurisdiction	Type of Program (Policy Approach)	Statute Web Link(s)
Arizona	Per-Pupil Funding (Direct Cash Assistance)	<a href="http://www.azleg.state.az.us/FormatDocument.asp?inDoc=/ars/15/00185.htm&amp;Title=15&amp;DocType=ARS">http://www.azleg.state.az.us/FormatDocument.asp?inDoc=/ars/15/00185.htm&amp;Title=15&amp;DocType=ARS</a> (Go to Sec. B4 for "equalization assistance")
	Qualified Zone Academy Bonds (Ability to Borrow)	<a href="http://www.azleg.state.az.us/ArizonaRevisedStatutes.asp">http://www.azleg.state.az.us/ArizonaRevisedStatutes.asp</a> (Search for the full title of statute, authorization of state school improvement revenue bonds, or for the section of law, using phrase "15-2081.")
California	Charter Schools Facilities Program (Ability to Borrow)	<a href="http://www.leginfo.ca.gov/cgi-bin/displaycode?section=edc&amp;group=17001-18000&amp;file=17078.52-17078.66">http://www.leginfo.ca.gov/cgi-bin/displaycode?section=edc&amp;group=17001-18000&amp;file=17078.52-17078.66</a>
	Qualified Zone Academy Bonds (Ability to Borrow)	There is no state legislation for Qualified Zone Academy Bonds (QZAB) in California. The following link provides the text of the federal law governing the QZAB program: <a href="http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&amp;docid=Cite:+26USC1397E">http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&amp;docid=Cite:+26USC1397E</a>
	Proposition 39 (Provision of District Facilities)	<a href="http://leginfo.ca.gov/cgi-bin/displaycode?section=edc&amp;group=47001-48000&amp;file=47610-47615">http://leginfo.ca.gov/cgi-bin/displaycode?section=edc&amp;group=47001-48000&amp;file=47610-47615</a> (Go to Sec. 47614)
Colorado	Colorado Educational and Cultural Facilities (Ability to Borrow)	<a href="http://www.michie.com/colorado/lpext.dll?f=templates&amp;fn=main-h.htm&amp;cp">http://www.michie.com/colorado/lpext.dll?f=templates&amp;fn=main-h.htm&amp;cp</a> (Go to Colorado Statutes => Title 23 Higher Education and Vocational Training => Article 15 Colorado Educational and Cultural Facilities Authority => Secs. 23-15-101 to 23-15-131)
	Moral obligation provision (Ability to Borrow)	<a href="http://www.michie.com/colorado/lpext.dll?f=templates&amp;fn=main-h.htm&amp;cp">http://www.michie.com/colorado/lpext.dll?f=templates&amp;fn=main-h.htm&amp;cp</a> (Go to Colorado Statutes => Title 22 Education => Article 30.5 Charter Schools => Secs. 22-30.5-407 and 408)
	Availability of intercept mechanism (Ability to Borrow)	<a href="http://www.michie.com/colorado/lpext.dll?f=templates&amp;fn=main-h.htm&amp;cp">http://www.michie.com/colorado/lpext.dll?f=templates&amp;fn=main-h.htm&amp;cp</a> (Go to Colorado Statutes => Title 22 Education => Article 30.5 Charter Schools=> Sec. 406)
	Clarification of charter schools as nonprofit entities (Ability to Borrow)	<a href="http://www.michie.com/colorado/lpext.dll?f=templates&amp;fn=main-h.htm&amp;cp">http://www.michie.com/colorado/lpext.dll?f=templates&amp;fn=main-h.htm&amp;cp</a> (Go to Colorado Revised Statutes => Title 22 Education => Article 30.5 Charter Schools=> Sec. 104)
	Provision clarifying that districts may not charge rent for space deemed available (Provision of District Facilities)	<a href="http://www.michie.com/colorado/lpext.dll?f=templates&amp;fn=main-h.htm&amp;cp">http://www.michie.com/colorado/lpext.dll?f=templates&amp;fn=main-h.htm&amp;cp</a> (Go to Colorado Revised Statutes => Title 22 Education => Article 30.5 Charter Schools=> Sec. 104)

**Table B1.** (cont'd.)

Name of Jurisdiction	Type of Program (Policy Approach)	Statute Web Link(s)
Massachusetts	Per-Pupil Facilities Allocation (Direct Cash Assistance)	<a href="http://www.mass.gov/legis/laws/mgl/71-89.htm">http://www.mass.gov/legis/laws/mgl/71-89.htm</a> (Go to Sec. 89nn)  For fiscal year 2007–08 budget language: <a href="http://www.mass.gov/legis/laws/seslaw07/sl070061.htm">http://www.mass.gov/legis/laws/seslaw07/sl070061.htm</a> (Go to line item 7061-9010)
	Massachusetts Development Finance Agency (Ability to Borrow)	<a href="http://www.mass.gov/legis/laws/mgl/23g-8.htm">http://www.mass.gov/legis/laws/mgl/23g-8.htm</a>
	Qualified Zone Academy Bonds (Ability to Borrow)	There is no state legislation for Qualified Zone Academy Bonds (QZAB) in Massachusetts. The following link provides the text of the federal law governing the QZAB program: <a href="http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&amp;docid=Cite:+26USC1397E">http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&amp;docid=Cite:+26USC1397E</a>
Michigan	Michigan Public Educational Facilities Authority (Ability to Borrow)	<a href="http://www.michiganlegislature.org/milegasp?page=getObject&amp;objName=mcl-12-192">http://www.michiganlegislature.org/milegasp?page=getObject&amp;objName=mcl-12-192</a>
	Qualified Zone Academy Bonds (Ability to Borrow)	There is no state legislation for Qualified Zone Academy Bonds (QZAB) in Michigan. The following link provides the text of the federal law governing the QZAB program: <a href="http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&amp;docid=Cite:+26USC1397E">http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&amp;docid=Cite:+26USC1397E</a>
	Availability of intercept mechanism (Ability to Borrow)	<a href="http://house.michigan.gov/hfa/PDFs/school_aid_act_2006.pdf">http://house.michigan.gov/hfa/PDFs/school_aid_act_2006.pdf</a> (Go to Michigan State Aid Act => Section 388.1617a)
	Debt-service reserve (Ability to Borrow)	There is no state statute related to the debt-service reserve.
Minnesota	Per-Pupil Building Lease Aid Program (Direct Cash Assistance)	<a href="http://ros.leg.mn/bin/getpub.php?pubtype=STAT_CHAP&amp;year=2006&amp;section=124D#stat.124D.11.0">http://ros.leg.mn/bin/getpub.php?pubtype=STAT_CHAP&amp;year=2006&amp;section=124D#stat.124D.11.0</a> (Go to Subdivision 4)
New Mexico	Lease Payment Assistance Program (Direct Cash Assistance)	<a href="http://www.conwaygreene.com/nmsu/lpext.dll?f=templates&amp;fn=main-h.htm&amp;2.0">http://www.conwaygreene.com/nmsu/lpext.dll?f=templates&amp;fn=main-h.htm&amp;2.0</a> (Go to New Mexico Statutes => Statutory Chapters in New Mexico Statutes Annotated 1978 => Chapter 22 Public Schools => Article 24 Public School Capital Outlay => Sec. 22-24-4[1])



**Table B1.** (cont'd.)

Name of Jurisdiction	Type of Program (Policy Approach)	Statute Web Link(s)
Texas	Texas Public Finance Authority (Ability to Borrow)	<a href="http://lo2.tlc.state.tx.us/statutes/docs/ED/content/html/ed.003.00.000053.00.htm#53.351.00">http://lo2.tlc.state.tx.us/statutes/docs/ED/content/html/ed.003.00.000053.00.htm#53.351.00</a> (Go to Sec. 53.48)
	Debt-service reserve (Ability to Borrow)	<a href="http://lo2.tlc.state.tx.us/statutes/docs/ED/content/html/ed.003.00.000053.00.htm#53.351.00">http://lo2.tlc.state.tx.us/statutes/docs/ED/content/html/ed.003.00.000053.00.htm#53.351.00</a> (Go to Sec. 53.351[e])
Washington, D.C.	Facilities Allowance for Public Charter Schools (Direct Cash Assistance)	<a href="http://government.westlaw.com/linkedslice/default.asp?rs=gvt1.0&amp;vr=2.0&amp;sp=dcc-1000">http://government.westlaw.com/linkedslice/default.asp?rs=gvt1.0&amp;vr=2.0&amp;sp=dcc-1000</a> (Go to District of Columbia Official Code => Title 38 Educational Institutions => Subtitle X School Funding => Chapter 29 Uniform Per-Student Funding Formula => Subchapter I General => Sec. 38-2908)
	Revenue Bond Program (Ability to Borrow)	<a href="http://government.westlaw.com/linkedslice/default.asp?rs=gvt1.0&amp;vr=2.0&amp;sp=dcc-1000">http://government.westlaw.com/linkedslice/default.asp?rs=gvt1.0&amp;vr=2.0&amp;sp=dcc-1000</a> (Go to District of Columbia Official Code => Title 1 Government Organization => Chapter 2 District of Columbia Home Rule => Subchapter IV The District Charter => Part E Borrowing => Subpart 5 Tax Exemptions; Legal Investment; Water Pollution; Reservoirs; Metro Contributions; and Revenue Bonds => Section 1-204.90)
	Qualified Zone Academy Bonds (Ability to Borrow)	<a href="http://government.westlaw.com/linkedslice/default.asp?rs=gvt1.0&amp;vr=2.0&amp;sp=dcc-1000">http://government.westlaw.com/linkedslice/default.asp?rs=gvt1.0&amp;vr=2.0&amp;sp=dcc-1000</a> (Go to District of Columbia Official Code => Title 47 Taxation, Licensing, Permits, Assessments, and Fees => Chapter 3 Budget and Financial Management; Borrowing; Deposit of Funds => Subchapter II-B. Industrial Revenue bonds=> Section 47-340.01)
	Direct Loan Fund for Charter School Improvement (Ability to Borrow)	<a href="http://government.westlaw.com/linkedslice/default.asp?rs=gvt1.0&amp;vr=2.0&amp;sp=dcc-1000">http://government.westlaw.com/linkedslice/default.asp?rs=gvt1.0&amp;vr=2.0&amp;sp=dcc-1000</a> (Go to District of Columbia Official Code => Title 38 Educational Institutions => Subtitle IV Public Education Charter Schools => Chapter 18A Miscellaneous Public Charter School Provisions => Subchapter II Public Charter School Financing and Support => Section 38-1833.02)
	Preference in leasing or purchasing public school facilities (Provision of District Facilities)	<a href="http://government.westlaw.com/linkedslice/default.asp?rs=gvt1.0&amp;vr=2.0&amp;sp=dcc-1000">http://government.westlaw.com/linkedslice/default.asp?rs=gvt1.0&amp;vr=2.0&amp;sp=dcc-1000</a> (Go to District of Columbia Official Code => Title 38 Educational Institutions => Subtitle IV Public Education Charter Schools => Chapter 18 District of Columbia School Reform (Public Charter Schools) => Subchapter II Public Charter Schools => Section 38-1802.09)

**Source:** State, federal, and District of Columbia Web sites as listed in the table.



## APPENDIX C

# Resources

***The Answer Key: How to Plan, Develop, and Finance Your Charter School Facility (authored and published by NCB Development Corporation)***

Through a link on the Web site of the nonprofit NCB Capital Impact (formerly NCB Development Corporation), a community development finance institution offering access to capital and expert technical assistance that might otherwise be unavailable for low- and moderate-income communities, readers can register to access this free publication. It guides charter school operators through the process of conceptualizing and implementing a facilities development project. The publication includes worksheets, expert advice on critical issues, organization tips, and other relevant information.

<http://www.ncbcapitalimpact.org/default.aspx?id=42>

**Local Initiatives Support Corporation**

The Web site of the Local Initiatives Support Corporation, a community development finance institution active in providing and enhancing facilities financing for charter schools, includes an online annotated library of resources on a variety of topics, including education facilities, which can be filtered by date and type (e.g., research paper, guidebook, article, etc.).

<http://www.lisc.org>

**National Alliance for Public Charter Schools**

The National Alliance for Public Charter Schools Web site provides a variety of online publications related to charter school development, policies and performance, current state-specific information related to charter schools, and a database for comparing charter school policies. The database, which is maintained in partnership with the Education

Commission of the States, is available through a hyperlink (“Visit the Online Charter School Database and Compare Charter School Policies”) found at <http://www.publiccharters.org/states>.

<http://www.publiccharters.org>

**U.S. Department of Education: Charter Schools Program**

This Web site provides detailed information and printable documents regarding the federal Charter Schools Program. This program provides financial assistance for the planning, program design, and initial implementation of charter schools, and the dissemination of information on charter schools.

<http://www.ed.gov/programs/charter/index.html>

**U.S. Department of Education: Credit Enhancement for Charter School Facilities**

This Web site provides more information regarding this federal credit enhancement program. This program provides grants to eligible entities to leverage funds through credit enhancement initiatives in order to assist charter schools in using private sector capital to acquire, construct, renovate, or lease academic facilities.

<http://www.ed.gov/programs/charterfacilities/index.html>

**U.S. Department of Education: State Charter School Facilities Incentive Grants Program**

This Web site provides more detailed information regarding the State Charter School Facilities Incentive Grants Program. This program provides grants to eligible states to help them establish or enhance, and administer, per-pupil facilities aid programs for charter schools.

<http://www.ed.gov/programs/statecharter/index.html>

*The above information is provided for the reader's convenience. The U.S. Department of Education is not responsible for controlling or guaranteeing the accuracy, relevance, timeliness, or completeness of any outside information. Further, the inclusion of these resources does not reflect their importance, nor is it intended to endorse any views expressed, or products or services offered.*





# Glossary of Finance-related Terms

**Bond.** A debt instrument through which an investor loans money to a borrower for a set period of time at an agreed-upon interest rate.

**Bond counsel.** A lawyer or law firm retained, usually by a bond issuer, to help ensure that the issuer is authorized to issue the proposed bonds and that all legal, including tax-related, requirements are met.

**Bond maturity date.** The date on which a borrower must pay bondholders any remaining principal and interest on the loan.

**Bond term.** The lifespan of the investment, that is, the time from when bonds are issued until all payments must be made by the borrower and received by the lender.

**Categorical aid.** Support from the state or federal governments that is targeted for a particular purpose or program (e.g., special education) and, with rare exception, cannot be spent on anything else. In education, such money is usually given in addition to general-purpose revenue.

**Conduit issuer.** A public entity, such as a state bonding agency or a city, that may issue a tax-exempt bond on behalf of a third party, such as a hospital or a charter school. A conduit issuer provides indirect access to financing. A conduit issuer is not an underwriter but works with one.

**Construction inflation index.** A statistical measure of changes in the cost of construction over time in a specific area (e.g., region, state).

**Credit enhancement.** Improving the credit-worthiness of an entity or individual seeking financing.

**Debt-service reserve fund.** An account established and uniquely dedicated to paying off bonded debt if a borrower defaults on a loan.

**General obligation bond.** A bond backed by the full faith and credit of the government and repaid through a variety of tax revenues.

**Letter of credit.** Arrangement with a bank or other lending institution that agrees to substitute its credit for the borrower's credit and guarantees payment of the borrower's debt up to a specified amount. Borrower pays fees to the bank providing a letter of credit.

**Limited obligation bond** (also known as a revenue bond). A bond issued by a municipality, state, or other public entity authorized to build, acquire, or improve a revenue-producing property (e.g., public transit system, toll road). Revenue bonds are payable from specified revenues only, usually the revenues from the facility for which the bond was originally issued.

**Moral obligation bond.** A moral obligation is not backed by the full faith and credit of the government and the government is not legally obligated to repay the debt. A moral obligation is backed by the non-legally binding promise of a governmental entity to repay the debt.

**Municipal bonds.** A debt security issued by a state, municipality, or county to finance its capital expenditures. Municipal bonds are exempt from federal taxes and from most state and local taxes.

**Operational revenue.** Funding used to pay for regular, ongoing costs of doing business, such as staff salaries and utilities costs.

**Reserve fund.** A pool of money dedicated to repaying investors in the event of a loan default.

**Tax-exempt bonds.** Bonds for which earnings are exempt from federal taxes.

**Trustee.** An individual who holds or manages assets for the benefit of another. In the case of bonds, a trustee works on behalf of the bond issuer to handle administrative aspects of the loan (e.g., receiving payments from the borrower and passing them to the lenders).

**Underwriter.** The investment banker or group of investment bankers that purchase new bonds and earn money by distributing it to investors. As part of this, they evaluate the risks involved in the bonds.



# Notes

1. Chester E. Finn, Jr. et al., *Charter School Funding: Inequity's Next Frontier* (Washington, D.C.: Thomas B. Fordham Institute, Progress Analytics Institute, and Public Impact, 2005).
2. Bryan Hassel, *Charter School Facilities—Challenges and Solutions* (Chapel Hill, N.C.: Public Impact, 2005).
3. National Alliance for Public Charter Schools, "About Charter Schools," <http://www.publiccharters.org> (accessed July 9, 2008).
4. Carol Ascher et al., *The Finance Gap: Charter Schools and their Facilities* (New York: The Education Facilities Financing Center of Local Initiatives Support Corporation, 2004).
5. National Alliance for Public Charter Schools, "About Charter Schools," <http://www.publiccharters.org> (accessed July 9, 2008).
6. Affordable access to appropriate facilities was identified as a common challenge for charter schools by members of the advisory group convened for the study on which this guide is based, as well as by many of those interviewed for the study (see table A1, "Respondents Interviewed for This Guide," in appendix A, Research Methodology).
7. For more information, see the "State Charter School Facilities Incentive Grants Program" page on the U.S. Department of Education's Web site, <http://www.ed.gov/programs/charterfacilities/index.html> (accessed June 25, 2008).
8. For more information about the program, see the "Credit Enhancement for Charter School Facilities" page on the U.S. Department of Education's Web site, <http://www.ed.gov/programs/charterfacilities/index.html> (accessed Nov. 17, 2008).
9. For full descriptions of these programs, see Elise Balboni et al., *2007 Charter School Facility Finance Landscape* (New York: The Education Facilities Financing Center of Local Initiatives Support Corporation, 2007).
10. Balboni et al., 2007.
11. Ibid.
12. Ibid.
13. Hassel, 2005.
14. According to LISC's *2007 Charter School Facility Finance Landscape* publication, 30 of the 41 jurisdictions with charter legislation do not offer supplemental per-pupil aid for facilities-related expenses (Balboni et al., 2007).
15. See the Center for Education Reform's table, "State-by-state Funding Comparisons," available at [http://www.edreform.com/charter\\_schools/funding/chart.htm](http://www.edreform.com/charter_schools/funding/chart.htm) (accessed Nov. 17, 2008).
16. Massachusetts has two types of charter schools. Almost 90 percent are "Commonwealth" charters, and all of them receive state facilities funding. The others are "Horace Mann" charter schools. Commonwealth schools are entirely independent, while the charter applications of Horace Mann schools require approval by the local teachers union and the school committee of the district in which they plan to locate. Funding for Horace Mann schools is determined through the local budget process of the district, which also provides these schools with facilities.
17. For information about the differing costs of construction alone (not including land, for example) for primary, middle, and high schools, see the "McGraw-Hill Construction Monthly, Historical, and Forecast Data" provided by the National Clearinghouse for Educational Facilities. Costs for additions, alterations, and new buildings are provided by grade range (i.e., primary, middle, high school) and by project cost per square foot. The data, updated monthly, are available at <http://www.edfacilities.org/ds/index.cfm> (accessed July 9, 2008).
18. This additional per-pupil funding also is intended to offset transportation expenses.
19. The legislature first enacted lease aid at a lower maximum amount, then gradually increased the maximum to \$1,500 per student; but, as part of an overall deficit reduction effort in the state, the legislature subsequently reduced the maximum to \$1,200 per student, although grandfathering in older schools at the prior rate.
20. According to an Arizona State Senate *Issue Brief* (Aug. 29, 2007, p. 3), basic state aid is computed differently for district schools than it is for charter

schools. In addition to the “base support level,” district schools receive separate funding components intended to support the costs of textbooks, transportation, and soft capital (such as computers, lab equipment, and furniture) that are not used in the charter school funding formula. The issue brief is available at [http://www.arizonaea.org/pdfs/politics/briefings/State\\_Aid\\_8.29.07.pdf](http://www.arizonaea.org/pdfs/politics/briefings/State_Aid_8.29.07.pdf) (accessed Aug. 19, 2008).

21. See *District of Columbia School Reform Act of 1995*, Title 38, Educational Institutions => Subtitle IV. Public Education Charter Schools => Chapter 18. District of Columbia School Reform => Subchapter II. Public Charter Schools. Sec. 38-1802.04 Duties, Powers, and Other Requirements, of Public Charter Schools.

22. A balance sheet is a financial statement that summarizes the value of an entity’s assets and debts. Charter school balance sheets give investors (or potential investors) a sense of what a given school owns and owes at a specific point in time.

23. According to a presentation made by the Arizona Charter Schools Association to the Arizona Senate K–12 Education Committee in February 2008, construction costs rose by 12.85 percent in 2006 and 12.20 percent in 2007. See Arizona Charter Schools Association presentation (Feb. 20, 2008), “Discussion of Charter School Funding Needs,” Arizona Senate K–12 Education Committee, slide 6.

24. Hassel, 2005.

25. Shaka L. A. Mitchell and Jeanne Allen, *Solving the Charter School Funding Gap: The Seven Major Causes and What to Do About Them* (Washington, D.C.: The Center for Education Reform, 2005).

26. Bryan Hassel, *Paying for the Charter Schoolhouse: Policy Options for Charter School Facilities Financing* (St. Paul, Minn.: Charter Friends National Network, 1999).

27. For example, the highest rating given by Standard & Poor’s and Fitch is AAA and the lowest is C. The higher ratings these agencies give (i.e., AAA, AA, BBB) are considered high- or medium-quality investment grade, whereas lower ratings (i.e., BB, B, CCC, CC, C) are considered lower-quality and noninvestment grade.

28. Balboni et al., 2007.

29. See the full text of Colorado Senate bill 98082, available at [http://www.state.co.us/gov\\_dir/leg\\_dir/sess1998/sbills98/sb082.htm](http://www.state.co.us/gov_dir/leg_dir/sess1998/sbills98/sb082.htm) (accessed June 26, 2008).

30. Chapter 53, Texas *Education Code*, which authorizes higher education authorities to issue bonds for institutions of higher education, was enacted in 1971. The authority to issue bonds for charter schools was added in 1995, with the addition of Sec. 53.48. The authorization or direction for Texas Public Finance Authority (TPFA), a state agency, to create a nonprofit corporation to issue bonds for charters was enacted in 2001, with the addition of Sec. 53.351. The TPFA Charter School Finance Corporation was incorporated in 2003, and issued its first bonds on behalf of a charter school in 2004.

31. See Sec. 53.351 of the Texas *Education Code* and note that bond issuance is restricted to open-enrollment charter schools. Open-enrollment charter schools must comply with Chapter 12 of the Texas *Education Code*.

32. The *Home Rule Act*, Title VI, authorizes the U.S. Congress to exercise constitutional authority as legislature for the District. See Sec. 601 (D.C. Code 1-206), available online at <http://www.abfa.com/ogc/tit6.htm> (accessed June 26, 2008).

33. Personal conversation on Aug. 7, 2008, with Ann Fillingham, attorney at Dykema, Gossett PLLC in Lansing, Mich.

34. Internal Revenue Service, National Office Technical Advice Memorandum CASE-MIS No.: TAM-118916-06, Aug. 1, 2006.

35. Allison L. McConnell, “Regulation: IRS Affirms Michigan Charter School’s Right to Issue Debt Without Conduit,” *The Bond Buyer: The Daily Newspaper of Public Finance*, Aug. 31, 2006.

36. Ibid.

37. Internal Revenue Service, National Office Technical Advice Memorandum CASE-MIS No.: TAM-118916-06, Aug. 1, 2006.

38. Hassel, 2005.

39. Hassel, 1999.

40. For more information about QZABs, visit <http://www.ed.gov/programs/qualifiedzone/index.html> (accessed June 26, 2008).

41. Allison L. McConnell, “Regulation: IRS Issues Annual State-By-State QZAB Allocations,” *The*



*Bond Buyer: The Daily Newspaper of Public Finance*, Jan. 17, 2007.

42. Ibid.

43. Bryan Hassel, Katie Walter Esser, and J. Jon Schroeder, *Facilities Financing: New Models for Districts That Are Creating Schools New* (St. Paul, Minn.: Education Evolving, 2004).

44. Balboni et al., 2007.

45. See California *Code of Regulations*, Title 5, Sec. 15132[a].

46. Thornton Matheson, “Qualified Zone Academy Bond Issuance and Investment: Evidence from 2004 Form 8860 Data,” *SOI Bulletin*, 26, 4 (Spring 2007), <http://www.irs.gov/pub/irs-soi/07ebspringbulthorn.pdf> (accessed Aug. 7, 2008).

47. Hassel, 2005.

48. Ascher et al., 2004.

49. Proposition 47 was a \$13.1 billion general education facilities measure passed in 2002. Subsequent action by the state legislature slated \$100 million for the Charter School Facilities Program (CSFP). Similarly, \$300 million for CSFP was carved out of a total general obligation bond issuance of \$12.3 billion for Proposition 55 in 2004, and \$500 million was set aside for CSFP out of a total of \$10.4 billion for Proposition 1D in 2006.

50. Among the agencies are the California School Finance Authority (CSFA), the Office of Public School Construction (OPSC), the State Allocation Board (SAB), the Division of the State Architect, the Department of Toxic Substances Control, the Division of Occupational Safety and Health (Cal/OSHA), and the California Department of Education. A typical school district applying for funds from the parallel School Facilities Program for conventional public school facilities would be required to have these approvals in place prior to applying for these state funds.

51. Propositions 47 and 55, from 2002 and 2004, respectively.

52. A total of 34 projects have been awarded in propositions 47 and 55 funds to date. As of June 2008, five of these have received their full awards, and another 21 have sufficient time to “convert to a final apportionment” (i.e., secure the approvals necessary to receive their full awards). Eight other projects chose to rescind their awards for reasons

not specified by the Office of Public School Construction staff. Funds awarded to these projects have been returned to the program for use on other CSFP projects.

53. As additional projects convert, they will be apportioned based on the grant amount for the year in which the conversion application is funded. The 2008 grant amounts are as follows (these amounts include a 6 percent grant increase approved at the May 28, 2008, State Allocation Board monthly meeting): \$8,839 for elementary students, \$9,348 for middle school students, and \$11,893 for high school students.

54. The city of Indianapolis also has made it possible for charter schools to take advantage of its moral obligation pledge. The mayor there was successful in obtaining state legislative authorization for the Indianapolis City Bond Bank to finance charter schools.

55. See note 27.

56. One advisor, Elise Balboni, who is the vice president of education programs at the Local Initiatives Support Corporation (LISC), expresses the opinion that use of an intercept mechanism is not necessarily in the best interest of borrowers or lenders. She points out that intercepting a charter school’s regular source of revenue has the potential to escalate challenges for charter schools that, in turn, could lead to default on a loan. Because, in using an intercept mechanism, a school has no access to the revenue dedicated to loan repayment, it could be faced with cash flow problems that prevent it from making other payments essential to its operation (e.g., teacher salaries, electric bills). In this scenario, a school could be forced to shut down and lenders would need to foreclose on any outstanding debt. While a school that has not opted to use this mechanism might still default on a loan, Balboni notes that in such circumstances, a lender and borrower could still confer on how to restructure the loan—opening up the possibility of the school continuing to operate and the lender still receiving payments, albeit at a later date.

57. See the following Colorado Department of the Treasury Web page entitled, “Charter School Intercept and Moral Obligation Program,” for more information: <http://www.colorado.gov/cs/Satellite/Treasury/TR/1190277266181> (accessed June 8, 2008).

58. Hassel, 1999.

59. The information in this paragraph about Michigan's debt-service reserve fund derives from an interview with Kathleen O'Keefe, financial manager, Michigan Public Educational Facilities Authority.

60. The information in this paragraph about Texas' debt-service reserve fund derives from an interview with Kim Edwards, who, at the time of the interview, was executive director of the Texas Public Finance Authority.

61. See House Bill 6 of the 76th Legislature, which, among other charter school reforms, authorized the State Comptroller to establish a fund for credit enhancement of bonds issued by the TPFA Charter School Finance Corporation.

62. Barbara Page et al., *The Charter School Facility Finance Landscape: A National Mapping Survey of Private Nonprofit Providers and Public Initiatives* (New York: The Education Facilities Financing Center of Local Initiatives Support Corporation, 2005).

63. Ibid.

64. U.S. General Accounting Office, *Charter Schools: Limited Access to Facility Financing* (Washington, D.C.: U.S. General Accounting Office, 2000).

65. Hassel, 2005.

66. See Sec. 47614(b) of the *California Education Code*. (Also note that another major component of Proposition 39 lowered the percentage of the local electorate required to approve local school bonds in California from 66 to 55 percent.)

67. Ibid.

68. Ibid.

69. Ibid.

70. Note that Assembly Bill 544, which preceded and was replaced by Proposition 39, required districts to allow charter schools to use facilities not being utilized by the districts for instructional or administrative purposes, provided that charter schools assumed responsibility for maintaining these facilities.

71. The following court cases have followed adoption of Proposition 39: *Sequoia Union High School District v. Aurora Charter High School* (2003); *Allianza Charter School v. Pajaro Valley Unified School District* (2004); *Renaissance Academy v. Los Angeles Unified School District* (2005); *Environmental Charter High School v. Centinela Valley Union High School District* (2004); *Bullis Charter School v. Los Altos School District* (2005); *Ridgecrest Charter School v. Sierra Sands Unified School District* (2005); *California Charter Schools Association et al. v. San Diego Unified School District* (2006); and *California Charter Schools Association, Green Dot, PUC et al. v. LAUSD* (2008).

72. See Sec. 22-30.5-104(7)(c) of the *Colorado Revised Statutes*.

73. Charter advocates in Minnesota also have been discussing legislation to prohibit districts from having policies that deny charter schools access to surplus district facilities. The Minneapolis School District, for example, has such a policy despite having numerous excess classrooms and having local charter schools begging for access to the district's surplus space. As of July 2008, that policy was under review by the district and negotiations were underway with several charter schools seeking to use excess district space.

74. See Secs. 11969.7 and 11969.8 of the *California Code of Regulations*.

75. Hassel, 1999.

76. Paul Minney statement during question-and-answer period following session entitled, "How can my charter school get school district facilities through Prop. 39?" (Sacramento: California Charter Schools Association Annual Conference, March 5, 2008).

77. Hassel, 2005.

78. Nikola Filby, *Approach to Methodological Rigor in the Innovation Guides*, working paper (WestEd, San Francisco, 2006).



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