



Comptroller of the Currency
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Community Developments *Investments*

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Charter School Financing Opportunities



A Look Inside ...

Barry Wides, Deputy Comptroller, Community Affairs, OCC

Public schools are the cornerstones of our communities. But quality education and the percentage of successful graduates have decreased over the past three decades, especially in inner-city areas. To address the issue of quality education, many parents, teachers, and community activists have joined forces to establish independent public schools called charter schools. These schools offer an alternative for their communities, and many offer a financial opportunity for banks.

Financing can be difficult for public charter schools because many lenders are unaware of the credit enhancements that are available. The articles in this issue of *Community Developments Investments* give facts about charter schools based on data collected over the past two decades



North Star Academy, a member of Uncommon Schools

Students at North Star Academy, in Newark, New Jersey, work to excel. North Star charter schools consistently outperform their neighboring district schools and rank among the top schools in Newark and New Jersey.

and help clarify the present status of charter school financing and the need for new private financing partners.

Charter schools are not a perfect answer to today's education problems, but in some cases they are showing potential for success in their improved student test scores and increasing numbers of graduates. You can learn more about the achievement gap that exists today and how charter schools are helping to narrow that gap in our

article "Why Charter Schools?" (see page 4).

One critical problem that is common among many charter schools is the lack of available financing for the purchase of school buildings. In response, a small number of nonprofit financial organizations and foundations have partnered with banks to offer financing for school facility purchase and renovation. To support these financial arrangements and reduce lender risk, the U.S. Department of Education has developed a credit enhancement

Community Developments

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Cover photo courtesy Harlem Children's Zone

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This and previous editions are available at
www.occ.gov/cdd/resource.htm.

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Resources for Charter School Information

National Organizations

- **US Charter Schools**
(www.uscharterschools.org/pub/uscs_docs/index.htm). This is a consortium of organizations whose goal is to provide accurate information and promising practices about and for charter schools. It is a good source for research materials, financing information, and guidance on federal programs.
- **Local Initiatives Support Corporation's Educational Facilities Financing Center** (www.lisc.org/section/ourwork/national/education). Several years ago, a broader vision of community development came together in an ambitious new strategic plan for LISC, to create what the organization calls Sustainable Communities. To that end, LISC's focus has turned to the next phase of building healthy communities: creating opportunities for residents of those communities to raise their incomes, build assets, and gain access to quality education, health care, jobs, services, and recreational amenities.

- **National Association of Charter School Authorizers**
(www.qualitycharters.org). NACSA is a nonprofit membership organization committed to developing and maintaining high standards for charter school authorizing. Its interactive map, at www.qualitycharters.org/overview-interactive-map, has information on authorization state by state.
- **National Alliance for Public Charter Schools** (www.publiccharters.org). This is the leading national nonprofit organization committed to advancing the charter school movement. Its goal is to increase the number of high-quality charter schools available to all families, particularly in disadvantaged communities that lack access to quality public schools. The alliance provides assistance to state charter school associations and resource centers; develops and advocates for improved public policies; and serves as the united voice for this large and diverse movement. It provides data and facts at <http://dashboard.publiccharters.org/dashboard/home> and has information on facility funding.

State Organizations

- **California Charter Schools Association** (www.calcharters.org). The California Charter Schools Association is a state membership organization that provides a portfolio of programs and services for operating charter schools, charter development teams, charter support organizations, charter-friendly businesses, and charter professionals.
- **Info 101: Directory of State and National Charter School Organizations** (www.examiner.com/charter-schools-in-national/info-101-directory-of-state-and-national-charter-school-organizations). This is a list of official state and national charter school organizations, provided by Examiner.com, an information clearinghouse.
- **Education Commission of the States** (www.ecs.org). This group's mission is to help states develop effective policy and practice for public education by providing data, research, analysis, and leadership, and by facilitating collaboration, long-range strategic thinking, and the exchange of ideas among the states.

program for charter schools seeking financing assistance. You can read about the enhancement program in “Addressing the Finance Gap” (see page 8).

Banks can invest in charter schools through New Markets Tax Credit (NMTC) offerings. These investments may be eligible for Community Reinvestment Act positive consideration under

certain circumstances.¹ There also are opportunities to provide debt financing to facilitate NMTC transactions. Two of our articles, by officials of NCB Capital Impact (“Charter Schools: A Good Credit Risk to Improve Communities” on page 12) and the U.S. Bancorp Community Development Corporation (“Charter Schools Benefit From New Markets Tax

Credit Financing” on page 15), illustrate how this financing works.

If you are looking for a way to support your local community, financing a charter school may be an opportunity for you to explore. For resources on charter schools and more information, I encourage you to check out our resource guide above and to continue reading.

1. See “New Markets Tax Credits: Unlocking Investment Potential,” *Community Developments Insights* (February 2007): 4–5. Also see “Community Reinvestment Act, Interagency Questions and Answers,” *Federal Register*, March 11, 2010, vol. 75, no. 47, p. 11646, §__12(g)(13)-1.

Why Charter Schools?

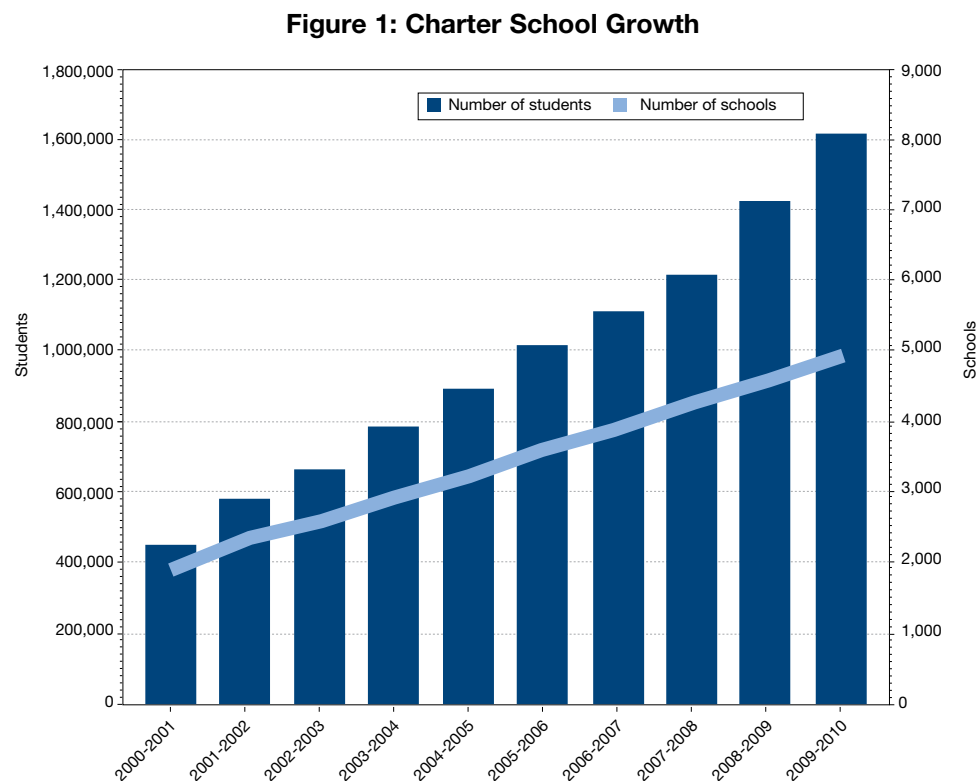
Elise Balboni, Project Director, Local Initiatives Support Corporation (LISC), and Ann Margaret Galatsos, Management and Program Analyst, U.S. Department of Education

Overview

Charter schools operate under a charter, or contract, with state-approved authorizing entities, such as local school districts, state departments of education, universities, other nonprofit groups, or specialized chartering boards. Like other public schools, charter schools do not charge tuition and are nonsectarian. In addition, charter schools may not practice selective enrollment.

The charter school movement is a response to the deteriorating performance of the public school system, most notably in urban areas, and to a persistent achievement gap between minority or low-income students and their peers. Minnesota passed the nation's first charter school law in 1991. Since then, the number of schools and the number of students attending charter schools have grown significantly. Today, approximately 5,000 charter schools educate more than 1.6 million students in 40 states and the District of Columbia. Charter schools represent 5 percent of all public schools nationally and serve 3 percent of all public school students.

Quality charter schools provide public education alternatives to low-income students and families that do not have the option of private education or moving to a



Source: National Alliance for Public Charter Schools

neighborhood with a quality district public school. Studies have shown that they can help boost educational achievement and the future earnings potential of their students. Beyond these benefits, successful charter schools also serve as community anchors and forces for revitalization. They help maintain and strengthen a community's population, redevelop deteriorating properties, provide a safe place to offer health and other community services, and ultimately act as a beacon, attracting further housing and business development.

Location

Charter schools tend to be located in low-income communities and low-performing school districts where the need for quality educational options is greatest. The New Orleans and Washington, D.C., school districts had the most charter schools in the United States in 2009–2010, and Los Angeles and Detroit had the most students enrolled. As illustrated in figure 2, in the 2008–2009 school year, more than half of all charter schools were located in urban areas, compared with 25 percent of all non-charter public schools.

Because they tend to be located in urban areas, charter schools serve a relatively higher percentage of minority and low-income students. Nationally, roughly 43 percent of charter school students are eligible for the federal free or reduced-price lunch program, compared with 40 percent in non-charter schools. In the 2009–2010 school year, charter schools nationally had a student body that was 56 percent black and Hispanic, compared with 38 percent in non-charter schools.

Charter School Academic Achievement

Charter schools disproportionately serve minority and low-income students in large, underperforming urban school districts. How have they performed academically? Do they outperform traditional district

public schools? The debate over these achievement questions has been fierce at times over the past two decades, frequently involving complex research methodology questions that can be difficult for the layperson, the press, and the general public to parse.

Table 1: Charter School Gains Compared With Those of Traditional Public Schools
(Based on Panel Studies Using Post-2001 Data)

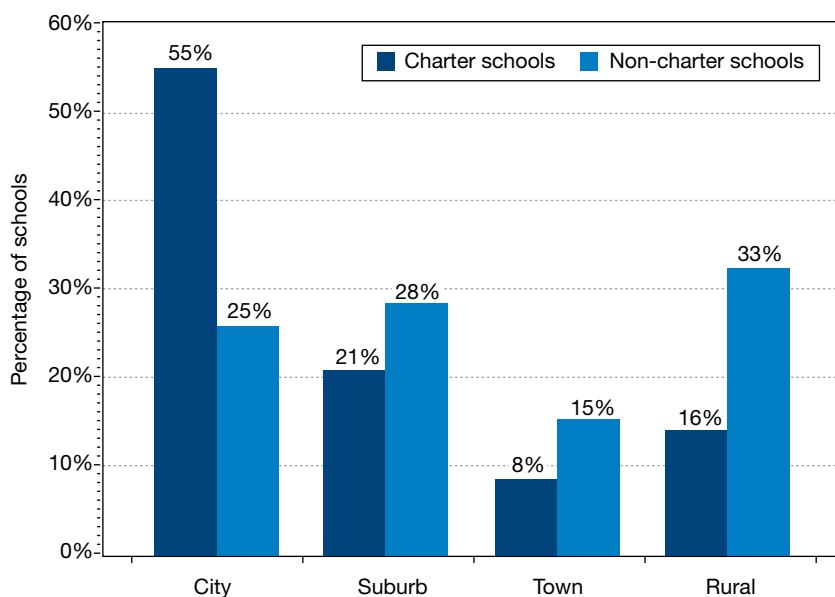
Level	Reading gains				Math gains			
	Larger	Similar	Mixed	Smaller	Larger	Similar	Mixed	Smaller
Elementary	5	2	2	6	5	4	2	5
Middle	9	6	1	4	10	6	2	3
High	9	2	0	4	7	4	1	4
Overall	12	9	0	9	15	5	0	10
Total	35	19	3	23	37	19	5	22

Source: “Measuring Charter Performance: A Review of Public Charter School Achievement Studies” (National Alliance for Public Charter Schools)

Note: Number of research findings totals more than 33 because most studies reported more than one finding (e.g., reading and math, elementary and middle, etc.). Overall means that the studies examined performance data using combined grade levels.

The charter school movement is a response to ... a persistent achievement gap between minority or low-income students and their peers.

Figure 2: Charter School Location (2008–2009 School Year)



Source: National Alliance for Public Charter Schools

There is no single definitive study that answers the question of how charter schools are performing compared with traditional public schools at the national, state, or even district level. There have been nearly 300 studies examining charter school performance, many with contradictory findings. In its December 2010 report, “Measuring Charter Performance: A Review of Public Charter School Achievement Studies” (www.publiccharters.org/publication/?id=118), the National Alliance for Public Charter Schools reviewed 203 studies that compared charter school achievement with

The Public School Achievement Gap

In November 2010, the U.S. Department of Education released “The Nation’s Report Card: Grade 12 Reading and Mathematics 2009” (<http://nces.ed.gov/pubsearch/pubsinfo.asp?pubid=2011455>). The report includes results of the National Assessment of Educational Progress (NAEP), an achievement measure for various subjects that has been conducted periodically since 1969. The 2009 “Nation’s Report Card” took nationally representative samples of 12th-graders from 1,670 schools across the nation. While the report showed that performance has improved in both reading and math since the last assessment in 2005, it also showed that racial and ethnic gaps persist.

In reading, the 2009 “Nation’s Report Card” showed a 27-point gap between white and black students and a 22-point gap between white and Hispanic students. These gaps were similar in magnitude to those of all assessments going back to 1992. Similarly, in math, the report showed a 30-point gap between white and black students and a 23-point gap between white and Hispanic students; the gaps were almost identical to those in 2005, the only comparable assessment year. These gaps translate roughly into average performance at or near proficiency for white students and at or near basic for black and Hispanic students.

An October 2010 study by the Council of the Great City Schools, a national organization representing the needs of urban public schools, examined the achievement gap specifically for black male students. The study analyzed NAEP proficiency levels nationally for black males and found that on the 2009 fourth-grade reading assessment, only 12 percent of black male students performed at or above proficient levels nationally, compared with 38 percent of white males. In eighth grade, only 9 percent of black males across the country performed at or above the proficient level in reading, compared with 33 percent of white males. Math results were similarly uneven in both grades.

that of traditional public schools and examined a significant segment of the charter sector. While the results of these studies were mixed, analysis of 33 high-quality studies that used longitudinally linked student-level data (“panel studies”) from 2001 and later shows that charter schools produce more instances of larger achievement gains in both math and reading when compared with traditional public schools (see table 1 on page 5).

Thirty-three studies also compared the achievement of students who stayed at a charter school for an extended period of time with that of traditional public school students. Of these studies, 21 found that charter school students showed larger gains

Securing adequate and affordable facilities remains a central challenge for charter schools.

the longer they were enrolled in charters, 11 found similar or mixed results, and one showed smaller gains for charters.

In addition to illustrating the need for more high-quality studies on charter performance, these studies underscore the fact that there is no “uniform”

or “average” charter school. When underwriting charter schools, it is important to analyze academic performance from both a mission and a financial perspective. Certain jurisdictions with strong charter environments, such as Massachusetts and New York City, have produced extremely strong charter schools. Some stand-alone charter schools and nonprofit charter management organizations seem to have found the right formula of culture, teaching, and curriculum that allows their students to make great gains in achievement and outperform not only district but also statewide performance benchmarks. An integral part of charter accountability is that poor or underperforming charters should be

closed and high-performing charters should be replicated, both within the charter sector and by sharing best practices with traditional district schools.

Outlook

The \$4.35 billion competitive federal Race to the Top grant fund, launched by the federal government in 2009, has given far greater visibility to charter schools as part of broader education reform efforts and has prompted the removal or loosening of state caps on charter growth. The year 2010 also featured the charter documentary film, with *Waiting for Superman* and *The Lottery*, among others, calling for reform with a sense of urgency not normally associated with large system change. Securing adequate and affordable facilities remains a central challenge for charter schools, however, hindering the growth of some of the nation's highest-performing schools and limiting the scale of the movement as a whole.

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LISC

Ánimo Pat Brown Charter High School, in Los Angeles, California, is committed to fostering a community of empowered learners and socially conscious and concerned citizens.

Fostering Public Policy Initiatives

Long-term sustainability of alternative education reform models requires consistent funding streams and increased access to public facility financing. The Educational Facilities Financing Center (EFFC) at the Local Initiatives Support Corporation (LISC), available at www.lisc.org, is helping to create and enhance state and federal financing mechanisms and documenting best practices in facility financing. As part of the documenting process, EFFC published "The Finance Gap: Charter Schools and Their Facilities" (<http://steinhardt.nyu.edu/scmsAdmin/uploads/001/117/FinanceGap.pdf>) in 2004 and its "Landscape" series (www.lisc.org/content/publications/detail/809) in 2005, 2007, and 2010.

The "2010 Charter School Facility Finance Landscape" (www.lisc.org/content/publications/detail/18446) is an updated mapping survey of private nonprofit and public financing programs for charter school facilities across the nation. It includes descriptions of private philanthropies and nonprofit organizations active in the sector and, for the first time, information on charter school access to the tax-exempt bond market. Performance data are provided for both loans and tax-exempt bond issues. Public initiatives are also detailed, including federal programs supportive of charter school facilities and state policies in all 40 jurisdictions with a charter law.

Addressing the Finance Gap

Elise Balboni, Project Director, Local Initiatives Support Corporation (LISC), and Ann Margaret Galiatsos, Management and Program Analyst, U.S. Department of Education

Overview

Despite charter schools' benefits for many communities and their success in improving student achievement (see "Why Charter Schools?" on page 4), there continues to be a mismatch in the market between the perception and reality of their creditworthiness for financing purposes. The actual repayment performance of charter schools that have borrowed to date is impressive. In its "2010 Charter School Facility Finance Landscape" (www.lisc.org/content/publications/detail/18446), the Local Initiatives Support Corporation reviews this performance and the impact that the federal credit enhancement program administered by the U.S. Department of Education has had in stimulating development of the sector.

Facilities Hurdle

Charter reform allowed for the creation of independent public charter schools but did not provide public facilities or public funding for facilities. Unlike traditional school districts, charter schools do not have taxing authority and must rely on their operating revenues and limited public capital funds to pay for their facilities. Of the 41 jurisdictions with a charter law, only 11 provide additional per-pupil funding specifically for facilities, with only three providing more than



Harlem Children's Zone

The Promise Academy charter schools run by Harlem Children's Zone in New York City provide an extended school day and school year to help ensure academic achievement.

\$1,000 on a per-pupil basis. As a result, facilities have been a major challenge for most charter school operators. Some school districts in major cities, such as New York City and Denver, have made district facilities available for some charters, but generally, charter operators have to find, develop, and finance their own buildings. Only about a third of the 5,000 charter schools operating in the United States are in their permanent facilities.

Charter School Funding

Charters receive public operating funding, known as per-pupil revenue, based on their enrollments. This revenue varies by state, both in terms of the absolute dollar amount and in the percentage a charter receives compared with a traditional district school in the same jurisdiction. Charters essentially finance both their academic programs and their buildings through this operating revenue stream.

A May 2010 report by Ball State University, “Charter School Funding: Inequity Persists” (<http://cms.bsu.edu/Academics/CollegesandDepartments/Teachers/Schools/Charter/CharterFunding.aspx>), analyzed charter funding in 24 states and the District of Columbia, which account for 93 percent of the nation’s charter school enrollment, to determine the magnitude of the funding discrepancy between charters and other public schools. It found that there was an average charter per-pupil funding gap of 19 percent, or \$2,247, when compared with traditional public schools in the same jurisdiction during the 2006–2007 school year. The gap was even larger—28 percent, or \$3,727 per pupil—in 40 urban areas, where almost half of the charter schools in the study were located. The report further found that lack of access to local funding and facilities capital funding were the primary sources of the funding disparity.

Early Market Development

The charter school facility financing sector was developed in its early phases by nonprofit community development organizations with support from the philanthropic community and the U.S. Department of Education. Traditional commercial lenders were reluctant to lend to start-up schools that generally had charter terms limited to between three and seven years, faced significant political opposition, and had no proven track record in the areas of academic achievement, student recruitment and retention, or financial management.

Table 2: Credit Enhancement Program (in Millions of Dollars)

Federal fiscal year	CE program awards	Financing leveraged	Number of charter schools
2001	\$24.96	\$0.00	0
2002	0.00	0.00	0
2003	24.77	56.38	21
2004	37.29	71.78	29
2005	36.94	109.69	36
2006	36.61	168.37	46
2007	36.53	342.72	64
2008	8.30	520.48	82
2009	8.26	631.49	57
2010	8.30	NA	NA
Total	\$221.96	\$1,900.91	335

Source: U.S. Department of Education
NA means data not available.

Faced with this major financing challenge, charter schools turned to nonprofit community development organizations (community development financial institutions and community foundations) serving their neighborhoods. As financial institutions with a mission of providing capital and technical assistance for low-income communities and residents, these organizations worked in the urban communities where charters tend to be located (see figure 2 on page 5) and had experience with underwriting riskier borrowers underserved by traditional lending sources.

Several nonprofit community development organizations made their first grants and loans to charter schools in the mid-1990s. Over time, they developed an expertise in underwriting early-stage loans to charter schools, and charter financing became an integral part of their loan portfolios.

U.S. Department of Education Credit Enhancement Program

While the community development financing organizations were the first to respond to charter financing needs, it was not until the creation of an innovative federal program that the sector began to develop in earnest. In 2001, Congress appropriated \$25 million for a pilot credit enhancement program, the Charter School Facilities Financing Demonstration Grant Program. Its successor, the Credit Enhancement

Generally, charter operators have to find, develop, and finance their own buildings.

for Charter School Facilities Program (CE Program), was authorized under the No Child Left Behind Act and since 2003 has received annual funding ranging from \$8 million to \$37 million.

Designed to stimulate private-sector financing for charter schools, the CE Program provides grant funds on a competitive basis to public and nonprofit entities to develop innovative credit enhancement models that leverage capital from the private sector. Program funds may not be used for the direct purchase, lease, renovation, or construction of facilities; they may be employed only to attract other financing for such purposes. To date, the CE Program (including its pilot form) has made 30 awards to 19 public and nonprofit entities totaling \$222 million and leveraging \$1.9 billion (see table 2 on page 9).

Data on the charter facilities sector indicate that loan volume increased significantly with the establishment of the CE Program. As of September 30, 2009, the \$222 million awarded to grantees had helped leverage \$1.9 billion in financing for 335 distinct charter schools (some of which benefited from multiple financings). (For more information on the program, see www.charterschoolcenter.org/resource/credit-enhancement-grantees.) As can be seen in table 2, because of the program's structure, the financing leveraged does not necessarily occur

in the year in which the award is made. Thus, loan volume continues to expand, although appropriation levels have been flat or declining, with loan volume in 2009 roughly 11 times greater than in 2003.

Nonprofit community development organizations ... need partners with larger capital resources willing to invest in this high-performing sector.

Of the 335 charter schools that have received credit enhancement through the CE program, as of September 30, 2009, only two had defaulted in a manner that resulted in an actual loss of grant funds. These two losses totaled \$335,000, which was 0.15 percent of the \$222 million in grant funds awarded and 0.02 percent of the \$1.9 billion in financing leveraged. This low percentage of loss is contrary to the perception of charters as risky borrowers.

Current Market and Track Record

LISC's 2010 "Landscape" identified 29 private nonprofit organizations that provide financing for charter school facilities. As of the end of 2009, these organizations had provided \$1.1 billion in direct financial support

(loans, grants, and guarantees) and another \$369 million in New Markets Tax Credit (NMTC) allocations for charter school facilities. Of the \$1.1 billion financing total, \$343 million, or 31 percent, has been repaid in full.

Because of their role in helping develop the market, these nonprofit organizations have tended to serve the "riskier" schools—those earlier in the charter school life cycle or those with little surplus cash flow or limited collateral. Despite this higher-risk profile, the default rate for charter school financing provided by these organizations is 1 percent measured as a percentage of originated financing, with realized losses of only 0.3 percent.

Private capital from traditional lenders and the tax-exempt bond market also has become more available. Several national financial institutions have invested significantly in the sector, including Prudential, Bank of America, Citigroup, and, most recently, JPMorgan Chase. Other regional commercial lenders have, on a smaller scale, financed schools in their geographic markets. This increased investment by traditional lenders was the result of the availability of enhancements to mitigate risks, incentives for investing in NMTCs, and potential eligibility for positive consideration under the Community Reinvestment Act (see "Charter Schools Benefit From New Markets Tax Credit Financing" on page 15).

In addition, older charter schools and schools with larger enrollments have been able to access the tax-exempt bond market. According to the 2010 “Landscape,” between 1999 and 2009, \$2.4 billion in rated tax-exempt debt was issued to finance charter school facilities. As would be expected with the higher credit quality necessary for the tax-exempt market, the default rate for this debt is lower than that of the nonprofit financing organizations. The default rate is 0.1 percent in terms of defaults that affected bondholders and 0.4 percent when taking into account additional cases where the charter school missed debt service payments, but bondholders were kept whole due to credit enhancement built into the issuance.

Challenges Ahead

Until charter schools receive equitable public provision of facilities, they will continue to look to the private sector for financing. Despite the schools’ strong track record of performance, progress in gaining access to such financing was slowed with the global credit crisis beginning in 2008. The downturn in the economy and tightening of credit as a result of the subprime mortgage crisis affected every private source of charter school facility financing. Many commercial lenders scaled back their community development lending, access to the tax-exempt bond market stalled with the collapse

of the municipal insurers, and many of the nonprofit community development lenders slowed their loan origination across all program areas, including charter schools.

While private financing sources rebounded in 2009 and 2010, they are still inadequate to meet the needs of this burgeoning sector. The universe of investors well-versed in charter underwriting remains too small for the growing number of charter schools, with misconceptions about the riskiness of charter loans more reflective of concerns relevant at the beginning of the movement two decades ago than of the actual

The actual repayment performance of charter schools that have borrowed to date is impressive.

repayment performance of schools that have borrowed. With bond insurance no longer an option and declining appropriations for the federal CE Program, there are fewer sources of credit enhancement available to bridge the perceived “credit gap” for charter schools. Certain philanthropies have stepped in with other forms of enhancement, but the need to expand the number of lenders and investors remains. Nonprofit community development organizations can continue to play an

New Markets Tax Credit Funding Extended

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, commonly referred to as the Tax Relief Act of 2010, extended (and modified) the New Markets Tax Credit (NMTC) program for investments in low-income communities. The act extended NMTCs through 2011, with a maximum allocation amount of \$3.5 billion for each of 2010 and 2011. These investments can include charter school facility financing. The NMTC is taken over seven years and is generally equal to 5 percent of the amount of the taxpayer’s investment for the first three years and 6 percent of the investment for the last four years (totaling 39 percent).

innovative role in structuring charter school facility financings, but they are limited in the amount of capital they can deploy. They need partners with larger capital resources willing to invest in this high-performing sector that plays such an important role in our nation’s education reform efforts.

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Charter Schools: A Good Credit Risk to Improve Communities

Scott Sporte, Managing Director, Community Investment Group, NCB Capital Impact

Charter schools offer banks a socially responsible investment opportunity that supports many struggling communities where they need it most. But they also offer a good credit risk, with lenders with large portfolios reporting strong performance over a period of many years. Fortunately for charter schools—which have a financing need conservatively estimated at \$1.3 billion annually and growing—the New Markets Tax Credit (NMTC) Program has been a catalytic tool for some banks entering this emerging market. (See “Charter Schools Benefit From New Markets Tax Credit Financing” on page 15.)

Bridging the Financial Gap

Charter schools are publicly funded but are allowed to operate largely independent of school districts in exchange for a high degree of accountability for their academic performance. Because they are typically structured as independent nonprofit organizations, however, charter schools do not have school districts’ ability to offer taxpayer-backed revenue bonds to finance facilities. Consequently, identifying and securing financing for their facilities is often one of charter schools’ greatest obstacles to growth.

Despite this challenge, the number of charter schools has grown quickly, which only heightens the need for substantial facilities financing. To meet the challenge, charter schools have turned to a variety of different financing options, and the role of



NCB Capital Impact

Jack H. Skirball Middle School, a charter school in Los Angeles, California, provides a positive learning environment, and its students have scored well on standardized tests. It is one of 18 schools operated by the Alliance for College-Ready Public Schools, a nonprofit charter management organization in Los Angeles.

banks is increasing as the market evolves. Organizations that have been involved in financing charter schools since the beginning of the movement in the early 1990s have been working actively as a bridge to bring traditional lenders into the market. Their experience shows that charter schools present a solid credit risk, and their access to financing structures and credit enhancement can help attract capital to the market. One such bridge organization is NCB Capital Impact, a nonprofit Community Development Financial Institution (CDFI) and an affiliate of NCB, which has been financing charter school facilities as part of its core mission since 1992. Because NCB Capital Impact is an organization dedicated to providing financing and technical assistance in

underserved areas, we view charter schools as an important part of our work to provide choices to people living in neighborhoods where few options exist for quality health care, education, housing, and employment.

Since 1995, NCB Capital Impact has provided more than \$475 million in financing to charter schools in underserved areas. Our investment has proven to be a solid one, with delinquencies averaging less than 2 percent and cumulative charge-offs of less than \$2 million, or less than 0.4 percent. Charter schools have been able to achieve an excellent social impact while presenting good credit risk. Our peer organizations—such as the Low Income Investment Fund (LIIF), the Reinvestment Fund (TRF), IFF, the Raza Development

Fund (RDF), Self-Help, and others—report similar outcomes.

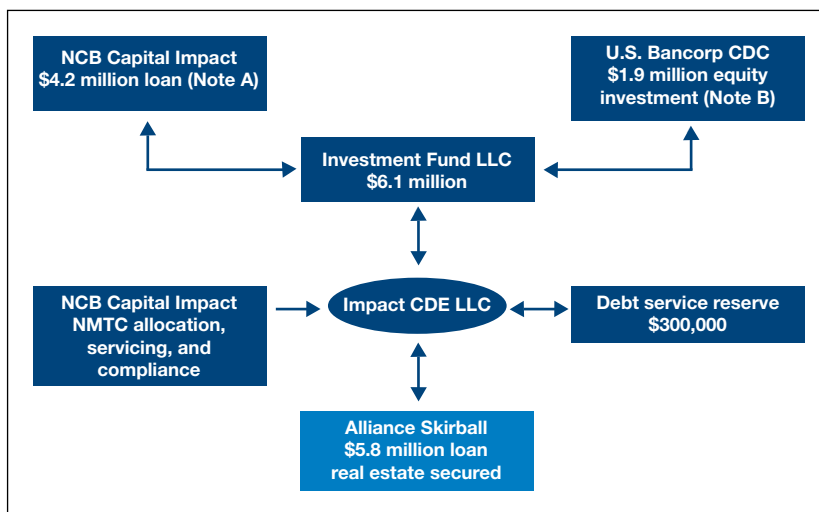
Financing With Partners

NCB Capital Impact has built on its lending track record by partnering with banks and other investors to finance charter school facilities. We have leveraged our experience in underwriting and managing charter school transactions by structuring financing pools through the use of subordinate debt, equity from programs like NMTC, and grants from the U.S. Department of Education (DOE) to provide credit enhancement. (See “Addressing the Finance Gap,” on page 8, for information on the DOE’s credit enhancement program.)

For example, we have created financing pools such as the Charter School Capital Access Program, a \$45 million project developed in partnership with TRF in Pennsylvania. Through this program, six banks came together to share senior debt representing nearly 80 percent of the pool. (NCB Capital Impact and TRF shared 20 percent subordinate debt, and the entire pool was supported by a 15 percent credit enhancement from a DOE grant.) With the credit enhancement providing a first loss guarantee, plus the subordinate debt, senior lenders were exposed to no more than 65 percent of each transaction, with debt service coverage averaging 1.5:1.0 and loan-to-value ratios of 50 percent or less. Through this pool structure, senior lenders were able to provide important capital to the charter school market while mitigating credit risk.

We have also made extensive use of the NMTC program to finance charter school facilities. Schools have

**Figure 3: Alliance Skirball Middle School NMTC Transaction
Leveraged A-B Structure**



been able to benefit from the below-market interest rates and the flexible financing criteria that the NMTC subsidy provides. In one recent transaction, NCB Capital Impact financed the Jack H. Skirball Middle School, a charter school affiliated with the Alliance for College-Ready Public Schools, a nonprofit charter management organization with 18 schools operating under its umbrella in Los Angeles, California. The Skirball school is located in Los Angeles’ Watts neighborhood, where more than 85 percent of enrolled students qualify for the federal free and reduced-price lunch program. The school has seen strong performance on standardized tests that exceeds the performance of area middle schools.

Leveraged New Markets Tax Credit Structure

The development of the Jack H. Skirball Middle School required approximately \$5.8 million in debt to acquire a site and finance demolition and new construction for a building to accommodate 375 students in

grades 6 through 8. The NMTC transaction used the leveraged A-B structure (see figure 3), where debt is used to leverage the tax credit equity, helping to maximize the subsidy to the school borrower. The leveraged A-B structure is common in NMTC transactions, where the tax credit is leveraged by a debt component to provide a stronger return to the tax credit investor. (See the OCC’s Insights report “New Markets Tax Credits: Unlocking Investment Potential” at www.occ.gov/static/community-affairs/insights/InsightsNMTC.pdf for more information about NMTCs.) In figure 3, Note A in the leveraged structure represents the debt and Note B represents the tax credit equity investor’s portion. Since the tax credit investor receives its return in the form of federal tax credits, the investor may not require a return of its original principal investment. As a result, the B note commonly carries a put/call agreement where the note can be put to the borrower for a nominal sum, at maturity, leaving significant equity (20 percent to 25 percent of the transaction) with the borrower.

NCB Capital Impact provided the allocation of NMTCs, which were purchased by the U.S. Bancorp Community Development Corporation (USBCDC), providing more than \$1.6 million in equity to the project (Note B, less the \$300,000 debt service received). NCB Capital Impact partnered with NCB, FSB (an Ohio thrift and subsidiary of NCB, with national operations) to share equally in the \$4.2 million leveraged debt portion of the transaction (Note A). The result of combining this A-B structure is \$5.8 million made available to Alliance Skirball through NCB Capital Impact's Community Development Entity (CDE) using the NMTC program.

Leveraged NMTC transactions are structured as conduit transactions, in which an investment fund LLC is capitalized with both debt and equity. In this transaction, NCB Capital Impact and NCB, FSB made leveraged loans to the investment fund, and USBCDC provided the equity investment to purchase the tax credits. The loans were priced at a market interest rate and were structured as seven-year interest-only transactions, as is common in leveraged NMTC deals, since lenders may not receive any return of principal. Loan-to-value on the loans from NCB Capital Impact and NCB, FSB was approximately 75 percent at closing, and the school was able to service the debt at approximately 1.35:1.0.

The investment fund then used its combined capital to take controlling interest in a CDE owned by NCB Capital Impact, which then used the investment proceeds to make a loan to the charter school. The structure is an effective way to leverage the tax credits, but it places some limitations on the lender.

The first limitation is on collateral. Because the lender's loan is to the investment fund, the lender does not have a direct mortgage security interest in the charter school facility. Its security is an assignment of the investment fund's ownership interest in the CDE and its collateral, which is the underlying charter school loan.

The second limitation is on foreclosure rights. Lenders to the investment fund are asked to agree to forbear from taking any action on the collateral during the seven-year NMTC compliance period, because under NMTC requirements, substantially all of the investment must be deployed to an eligible borrower, such as a charter school, or the investor runs the risk of recapture, having to repay the tax credits plus applicable penalties. If the investment fund lender forecloses on the collateral and uses the sale proceeds to repay its loan, recapture risk is triggered, so lender forbearance is the generally accepted method to protect against this risk.

We have made use of credit enhancement tools to help mitigate lender risks stemming from reduced access to the underlying collateral and the refinancing risk that comes from having a seven-year transaction

structured with no principal amortization. NMTC transactions are often structured with a 5 percent debt service reserve to make sure that payments continue to flow to lenders, even if the school experiences an operating issue. The debt service reserve is typically enough to cover one full year of debt payments, providing a helpful cash cushion. We have also made use of our DOE credit enhancement grant to support the lenders, pledging 10 percent of the principal balance to help offset the risk of a large balloon payment at loan maturity. Together these enhancements significantly reduce lender exposure and help attract regulated lenders such as NCB, FSB to these charter school transactions.

Our experience with charter schools has resulted in an excellent combination of positive community impact and appropriate credit risk. We are eager to bring other lenders to the charter school market, and we believe that our track record and experience demonstrate the strength and attractiveness of this important market.

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Stay up to date with the OCC Community Affairs News List Service. This online service delivers current news and information about OCC Community Affairs, our mission, and the national banking system.

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Charter Schools Benefit From New Markets Tax Credit Financing

Laura Vowell, Vice President and New Markets and Historic Tax Credit Investment Business Development Officer,
U.S. Bancorp Community Development Corporation

The New Markets Tax Credit Program (NMTC Program) is a popular and flexible community development financing tool that may be used for both the development of real estate facilities and the funding of operating businesses. (For further information, see “New Markets Tax Credit Funding Extended” on page 11.)

Established in 2000, the NMTC Program pairs traditional free-market forces with public resources—essentially teaming up the private sector and the federal government—to bring economic and community development to low-income communities. From job creation to increased access to essential educational, health, and retail services, and from the rehabilitation of blighted communities to the development of renewable energy sources, NMTC projects have benefited neighborhoods throughout the country.

NMTC financing allows community development corporations (CDC) and NMTC equity investors such as the U.S. Bancorp Community Development Corporation (USBCDC) to have a substantial positive impact on the communities they serve. The financial health of a project is, of course, important. Most bank CDCs are looking for returns—projects that have solid returns on investment (ROI) in the traditional sense. However, economic concerns are not a CDC’s sole criterion.

CDCs are also looking for projects that benefit their communities in multiple



U.S. Bancorp CDC

Students at Newark’s North Star Academy, one of the top-performing schools in New Jersey, are active learners. In 2009, more than 75 percent of its students qualified for free and reduced-price lunch.

ways and are redefining the term ROI. Facilitating a community’s access to quality education, for example, has been identified as an important aspect of most community development programs. Therefore, charter schools have been a popular project for NMTC investment.

NMTCs are meant to encourage patient, private investment in underserved neighborhoods in the United States and its territories. Instead of direct government investment in these projects, the NMTC Program allows Community Development Entities (CDE)—which are awarded NMTC allocation through a competitive process—to turn tax credits into real capital for projects by selling them to investors. Substantially all of the qualified equity investment must in turn be used by the CDE to provide investments in low-income communities.

Charter schools are a significant beneficiary of the NMTC Program, having partnered with CDEs that have used more than \$570 million in NMTC allocation authority since the program’s inception. This figure represents the amount of NMTC allocation used for charter schools as reported by allocatees in a 2009 survey by the Educational Facilities Financing Center and outlined in the Local Initiatives Support Corporation’s “2010 Charter School Facility Finance Landscape,” available at www.lisc.org/content/publications/detail/18446. (See “Fostering Public Policy Initiatives” on page 7.)

To fully comprehend the usefulness of the NMTC Program, it is important to understand what the benefits are to the involved parties. For the project, the NMTC Program allows the operating business, in this case a charter school, to partner with a CDE that has been

awarded NMTC allocation in order to receive capital with better rates and terms. By offering tax credits to investors with tax liability, the CDE attracts private capital and deploys substantially all of it to the project.

NMTC financing isn't the sole source of financing for these projects—in fact, NMTC financing most often acts as the gap filler for projects that have already attracted the majority of their funding sources. As a result, the NMTC benefit usually accounts for approximately 20 percent of a project's total cost. The most typical NMTC transaction is a leveraged structure in which one or more parties provide debt via loans, project-affiliate capital, and grants, and an investor provides equity in order to purchase the NMTCs. (See “Charter Schools: A Good Credit Risk to Improve Communities” on page 12.)

The USBCDC, a wholly owned subsidiary of U.S. Bank, is the nation's largest such NMTC purchaser. As an active investor in NMTCs, USBCDC has a portfolio containing more than 500 NMTC-financed projects representing \$8.7 billion of Qualified Equity Investments (QEI). More than \$323 million of total QEIs have helped support at least 20 charter schools.

NMTCs are an attractive investment for banks and other taxpaying organizations for numerous reasons. First, the investor can use the tax credits as a method of partially offsetting some federal or state income tax liabilities. The credit provided to the investor totals 39 percent of the amount of the QEI and flows over a period of seven years, during which time the funds must remain invested in the qualified business.

Second, because many of the qualifying projects are located in low-income communities, banks may

receive Community Reinvestment Act (CRA) credit for virtually all NMTC investments within their assessment areas. (For answers to CRA and NMTC questions, including information on Community Development Loans and Qualified Investments, see “Interagency Questions and Answers Regarding Community Investment” at www.minneapolisfed.org/news_events/events/community/060810/qa.pdf.) Not all banks, however, are limited to investing in those areas that allow them to receive CRA credit. For instance, U.S. Bank has retail banking operations in the Midwest and on the West Coast, but USBCDC invests throughout the country. Additionally, the structure of the program itself ensures that an NMTC is a sound investment, providing a solid, seven-year return to its purchaser with minimal risk.

NMTCs are well-suited for use in facility financing of permanent schools by established charter management organizations. The established charter management organizations are usually building schools of a certain critical size that is necessary to cover the fixed costs of the structured NMTC financing, and they have the track record to attract other, long-term sources.

Additionally, in order to be NMTC-eligible, projects must be in low-income communities or serve low-income individuals, which is the mission of most charter management organizations—to provide quality educational choices where there are few. Many charter schools have high student retention, offer extended school days in order to include expanded curriculums, and cultivate a commitment to excellence, which often are lacking in under-performing urban schools.

In 2009, USBCDC and the Low Income Investment Fund, a leading community development financial institution, used NMTCs to help finance the acquisition of two middle school locations for North Star Academy's long-term use in Newark, New Jersey—an excellent example of a project that benefited its community. North Star Academy is a member of Uncommon Schools, one of the most recognized charter management organizations in the country. Of North Star's 760 students enrolled across four campuses in 2009, more than 75 percent qualified for free and reduced-price lunch, and 99 percent were students of color.

North Star Academy charter schools consistently outperform their neighboring district schools, rank among the top schools in Newark and New Jersey, and have been recognized by *Bloomberg BusinessWeek* and *The New York Times*. Because North Star is not eligible to receive state funding for facilities projects, as traditional public schools are, it used NMTC financing to help purchase the properties and secure permanent financing.

“Despite our stellar results, North Star Academy, like other charter schools, faced significant challenges in securing financing for facilities,” said Michael Ambriz, chief operating officer of North Star Academy.

“Unlike traditional public schools, we do not receive state funding for facilities projects, so this transaction went a long way to provide an upgraded environment for our students that promoted both their personal and academic growth.” The key result of the investment was that North Star was able to continue to devote the majority of its operating funds to core academic

programming without incurring additional facility costs.

Since many charter schools use the leveraged structure in their NMTC financing, they must seek and receive commitments from other sources of capital. These often include capital campaigns, grants, private equity, and debt. While established charter management organizations are able to access some sources of traditional debt capital, there are still market limitations on the amount and terms of that debt.

According to the Local Initiatives Support Corporation’s “2010 Charter School Facility Finance Landscape” (www.lisc.org/content/publications/detail/18446), lack of access to appropriate public facilities or to public funding for facilities continues to be a major obstacle for these school operators. While the charter school financing sector expanded significantly over the past two decades with the help of nonprofit community development organizations, the U.S. Department of Education, traditional lenders, and the tax-exempt bond market, the economic slowdown in 2008 and tightening of credit standards affected every private source of charter school facility financing.

Traditional lenders often view charter schools as risky borrowers due to their lack of long-term security. Fitch Ratings notes that most rated charter schools are of low investment grade (BBB) credit quality, and the sector as a whole is largely non-investment grade (BB category). Because bond rating is a key determinant of borrowing costs, charter schools are not generally eligible to borrow money at lower interest rates as would other borrowers.

Thankfully, a number of Community Development Financial Institution

Table 3: Typical Charter School Proforma

Source	Amount	Common sources: <ul style="list-style-type: none"> • Debt from banks, bonds, CDFIs, or equity funds • Equity/grants from foundations, fundraising, and municipalities • Sponsor equity • NMTC equity
Grants (state, local)	\$ 3,000,000	
Equity (fundraising)	2,000,000	
Debt (bank, CDFI)	3,400,000	
NMTC equity (gross)	2,600,000	
Total	\$ 11,000,000	
Use	Amount	
Acquisition	\$ 1,500,000	
Hard cost/contingency	7,100,000	
Soft costs	1,300,000	
Furniture, fixtures, and equipment	500,000	
NMTC fees	600,000	
Total	\$ 11,000,000	

Source: U.S. Bancorp

lenders, many of which also serve as CDEs, have an appetite for charter school lending, allowing them to play multiple roles in an NMTC financing structure. (See “Charter Schools: A Good Credit Risk to Improve Communities” on page 12.) The downside is usually their lending limit, forcing the charter schools to use all of the sources mentioned before.

In this case, a common structure is as follows:

- The charter management organization (or other affiliate of the school) collects the proceeds of the various sources—fundraising, grants, equity, and debt—and makes a loan (“Leverage Loan”) to an Investment Fund.
- The Investment Fund pools the Leverage Loan with the NMTC equity from the investor and makes a QEI, as required by the NMTC rules, to the CDE.
- The CDE then lends or makes equity investments to a newly formed, single-purpose entity, the qualified business, which then operates the school or leases the property back to the charter management

organization. (To see how NMTC financing is structured, see figure 3 on page 13.)

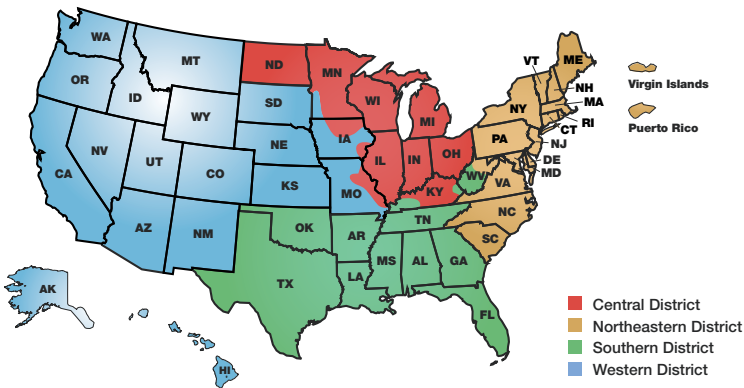
At the end of the NMTC compliance period, the investor and the CDE or CDEs exit the transaction, leaving the NMTC benefit with the project and allowing the charter management organization to refinance any debt sources as it sees fit.

Table 3 is an example of a typical charter school’s funding sources and their project uses.

There are costs to structuring project financing in this way. Each entity must be maintained through asset management fees, and the intermediaries receive fees for their role in administering compliance. Additionally, there are fixed legal and accounting costs associated with the structuring of the transaction. Nonetheless, numerous charter schools have been successfully financed via NMTCs, and charter schools are expected to remain a popular use of NMTC financing.

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This Just In ... OCC's Four Districts Report on New Opportunities for Banks



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Bank and Community Partners Increase Opportunities for Charter Schools

Three new charter school financing programs have recently been announced.

- JPMorgan Chase plans to partner with community organizations to help stimulate the growth of charter schools. Chase will provide much-needed financing for the development of school facilities by partnering with nonprofit community organizations such as the Reinvestment Fund (TRF), of Philadelphia, Pennsylvania; the Low Income Investment Fund (LIIF), of San Francisco, California; and NCB Capital Impact, of Arlington, Virginia. The initiative combines grants, debt financing, and New Markets Tax Credits (NMTC) to enable charter schools to acquire and improve facilities. Of the \$325 million committed by Chase, \$50 million will be in grants to Community Development Financial Institutions (CDFIs) active in funding charter school projects. The CDFIs can then use the grants as permanent equity and leverage the money to fund high-performing charter schools. Approximately \$175 million in debt and \$100 million in NMTCs also will be allocated for charter school facility projects.
- NCB Capital Impact has created an \$80 million fund to support charter schools around the country. In December 2010, the Alliance for College-Ready Public Schools, a California charter school network, was the first loan fund recipient. The financing is helping Alliance open a new high school for 550 students.
- TRF is providing \$50 million to finance real estate projects for established charter schools that are acquiring, renovating, or expanding facilities. The projects will be located in TRF's footprint—Pennsylvania, New Jersey, Maryland, Delaware, and Washington, D.C.—and will meet eligibility requirements for the NMTC Program.

To learn more about these partnerships and other opportunities, visit the Web sites of JPMorgan Chase (www.jpmorganchase.com/corporate/Corporate-Responsibility/document/CS4302_Community_Digital_FNL.pdf), NCB Capital Impact (www.ncbcapitalimpact.org), and TRF (www.trfund.com).



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New Ohio CDFI Promotes Economic Revitalization

The Finance Fund Capital Corporation, a statewide Community Development Financial Institution and the lending arm of the Finance Fund, promotes economic revitalization and community development in low-income communities by providing access to capital, facilitating investment, and financing opportunities throughout Ohio. To that end, its Community Investment Fund (CIF) provides financing for projects such as affordable housing and community facilities (a category that includes charter schools, community centers, and health clinics).

An investment commitment to the CIF has the potential to benefit the investor with a competitive return on investment, a Community Reinvestment Act credit-eligible investment, and Bank Enterprise Award eligibility. Such investments achieve significant community impact throughout Ohio's urban and rural communities. The terms of the fund are designed to provide a tailored program that fits all the investor's needs for community investing. Investment amounts can be as low as \$250,000 for investment in a pooled loan fund or more than \$1 million for a private loan fund. Terms range from five to seven years, and the investment offer is secured by business assets.

For more information, e-mail Valerie Heiby, Director of Development at the Finance Fund Capital Corporation, at vheiby@financefund.org, or call (614) 568-5055.



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Funding for Small Businesses in Arkansas

ACCG Lending, headquartered in Little Rock, Arkansas, is a group of small-business lending companies working together to assist small-business owners and their community banks with long-term financing options and risk-mitigation tools. ACCG Lending comprises the Arkansas Capital Corporation (ACC), the Six Bridges Capital Corporation (6BCC), and the Arkansas Capital Relending Corporation (ACRC).

Founded in 1957, the ACC has helped launch new economic development opportunities for businesses across the state. Since its inception, the family of companies has provided more than \$385 million in capital to small businesses in Arkansas. As an SBA and USDA Preferred Lender, ACC partners with numerous sources to mitigate the risks associated with providing capital to businesses. In 2002, ACC established the Heartland Renaissance Fund, a designated Community Development Entity (CDE) that is active in the New Markets Tax Credit industry and has received three allocation awards (totaling \$140 million) from the U.S. Department of the Treasury. Qualified investments into designated CDEs such as the Heartland Renaissance Fund provide investors with federal tax credit opportunities and provide capital to further spur economic development within federally designated low-income areas.

6BCC, established in 1989, is a statewide provider of Small Business Administration 504 loans. Through the use of long-term financing, 6BCC encourages economic development by giving small businesses the opportunity to acquire major fixed assets for expansion or modernization. The program's low down-payment requirements contribute to more operating cash available for operations of the small business.

In 1998, ACCG Lending created the ACRC as another financing tool to promote economic development and strengthen communities. In 2010, the ACRC was designated as a Community Development Financial Institution, allowing it to pursue federal grants or other low-cost sources of capital, which are then deployed in underserved markets across the state.

For more information on investment and lending opportunities, and on how your bank can partner with ACCG Lending, contact C. Sam Walls, chief executive officer, at (800) 216-7237, or visit the ACCG Lending Web site at <http://accglending.com>.



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Early-Stage Financing for Habitat for Humanity

The Mile High Community Loan Fund (MHCLF), a Denver-based Community Development Financial Institution (CDFI), and Habitat for Humanity Colorado (HFHC) have joined forces to fund the early-stage financing needs of Habitat for Humanity affiliates across Colorado. This partnership works in part because both MHCLF and HFHC share a mission of providing affordable housing for low- and moderate-income families.

This unique arrangement addresses timing issues faced by many Habitat for Humanity affiliates involved with financing real estate development projects, by offering them predevelopment, acquisition, construction, and mini-perm loans.

The Wells Fargo Community Development Corporation enabled this partnership by agreeing to fund a loan request by HFHC. In essence, HFHC re-lends these funds to its Colorado Habitat for Humanity affiliates. The Wells Fargo loan was structured as a five-year, low-interest subordinated note to HFHC. Subsequently, HFHC entered into a Memorandum of Understanding (MOU) with MHCLF, an expert in community development lending, to help it implement and manage this new loan fund program.

Under the MOU, MHCLF underwrites loan requests from Habitat for Humanity affiliates and then presents the loans to MHCLF's Loan Committee along with recommendations. HFHC makes the final credit decision but takes advantage of MHCLF's loan policies, product terms, credit infrastructure, and capacity to manage the program. If the loan is approved by HFHC, MHCLF then schedules a loan closing and services the loan on behalf of HFHC.

The two organizations work together to market the program to Habitat for Humanity affiliates and provide technical assistance to potential borrowers. In addition, on a case-by-case basis MHCLF also participates in loans, further leveraging funds and helping to mitigate risk. In 2010, HFHC and MHCLF made three loans totaling \$360,000 to Habitat for Humanity affiliates for land acquisition, resulting in 12 units.

For more information regarding this program, e-mail Jeff Seifried at jeffs@mhclf.org, or call (303) 860-1888, ext. 5.



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