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ABSTRACT

In 1991, the charter school movement began in Minnesota and since then, 28 more states and the District of Columbia have passed similar versions of charter school law. This paper examines a facility planning model designed to help charter schools maximize their chances of succeeding in the effort to secure permanent facilities. The model includes a facility feasibility element that sets the scale and quality towards which project charter schools can, and should, realistically aim to accomplish; an occupancy cost element that determines the level of total facility cost charter schools can, and should, bear; and a credit standards element that determines key financing and operating criteria that charter schools must be willing and able to meet to acquire permanent facilities through either leases or mortgages. The paper also includes a summary of leading facility financing arrangements currently in use by charter schools, and presents recommendations for enhancing charter school facility financing alternatives to benefit more charter schools and to advise prospective facility financing providers. (GR)

Massachusetts Charter School Resource Center

Charter School Facility Financing:

Constraints and Options

A study for the
Massachusetts Charter School Resource Center
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Introduction

The charter school movement began in Minnesota in 1991 with the passage of the first state charter school legislation. Since then, 28 more states and the District of Columbia have passed some version of a charter school law. Today, nearly 800 charter schools are operating in 23 states and the District of Columbia, and many more are planned for the near future.

Charter schools are tuition-free public schools that operate independently of local school board regulation. While typically required to meet basic state educational standards, charter schools are largely free to design and deliver their own programs. They can be started by parents, teachers, community groups, private firms, or other organizations or individuals. Depending on which states they operate in, charter schools can be sponsored by local or state school boards, colleges and universities, or other community agencies interested in fostering innovation in public schools.

Charter Schools' Limited Resources

In the aggregate, charter schools receive less money per student to operate and house themselves than do regular public schools. In all states in which they now operate, charter schools receive from 50% to 100% of the annual average funding per student allocated to *school operations* by the local school districts in which they are situated. Unlike regular public schools, however, they receive *no capital funds* in addition to their operating funds. By default, charter schools must pay for their facilities--be they temporary or permanent--out of their operating budgets if they are unable to secure suitable housing at no charge.

From a legal organizational standpoint, charter schools face further challenges in securing facilities. In many states, only non-profit 501 (c) (3) corporations are permitted to hold new school charters. Charter school founders typically form new non-profit organizations for the express purpose of applying for and obtaining such charters. These new entities have no assets and no credit or operating histories, which makes them poor candidates for leasing or buying permanent facilities.

The "High Rent/Temporary Space" Trap

Because of the structure and limited amount of their public funding, the biggest problem confronting charter schools at this point in their evolution is obtaining and paying for permanent facilities. Today, most charter schools are located in temporary space that is poorly suited to comprehensive educational programs and inadequate for growth. In Massachusetts, for example, charter schools have been located in sites ranging from a former convent (i.e., the Atlantis Charter School of Fall River), to a mini-mall storefront (i.e., the Cape Cod Lighthouse Charter School), to vacant motel space (i.e., the South Shore Charter School of Hull). Only two Massachusetts charter schools actually own their facilities, one thanks to a generous corporate donation of a moth-balled office building (i.e., the Lawrence Family Development Charter School), and the other through economical purchase of several mobile classrooms joined together to form one facility (i.e., the Martha's Vineyard Public Charter School).

When it first opens, the typical charter school cannot secure more than temporary space because it lacks both tangible assets and an operating history that would give conventional lenders or landlords the collateral and confidence they require to provide long-term mortgage or lease financing for the school's facility. Consequently, the school has little choice but to enter into a short-term lease for an "as-is" facility, and to pay a relatively high rent that reflects the landlord's requirement of a risk premium to lease *any* space at all to the school.

Paying a high rent for its facility year after year, the typical charter school is unable to accumulate reserves without compromising its academic program. This makes it very difficult for the school to reach a point at which it can afford either to buy or lease a suitable permanent facility on economically favorable terms.

To escape the trap of continuing to pay high rents for temporary space--and to be able to plan and grow predictably without sacrificing program standards--charter schools must either obtain significant public or charitable resources *in addition to* their current public funding, or find a way to finance suitable facilities within their current means. Given a contentious political climate, the provision of significant additional public or charitable resources to charter schools, especially for the purpose of securing permanent facilities, is not likely to occur in the near term. With regard to public resources, state lawmakers and executives have already expended a large amount of political capital in recent years just to bring about the creation of charter schools under current funding formulas; they likely will remain reluctant to propose any meaningful supplemental public funding for charter schools for the foreseeable future. (Indeed, one of the implicit arguments made to create charter schools in the first place was that these new schools could provide a better educational "product" more efficiently--that is, less expensively--than regular public schools. For those who relied even a little bit on this argument in the original effort to establish charter schools to argue now that charter schools must have the same public resources regular public schools have if they are to succeed would sound inconsistent at best and hypocritical at worst.)

With regard to charitable resources, philanthropic individuals and organizations currently interested in contributing to charter schools are too few in number to help more than a small fraction of charter schools around the country. Many foundations do not contribute to capital projects as a matter of policy. Of those that will support capital projects, the funds they so far have been willing to invest are relatively small and inadequate for financing permanent facilities. As an opportunity for philanthropy, charter schools are still too new and untested in comparison to other charitable causes to which these contributors might subscribe.

Objective Of This Paper

If in fact charter schools cannot expect to receive significant additional public or charitable resources for the foreseeable future, they will have to try to stand on their own in acquiring permanent facilities. Within their current and projected means, charter schools will have to secure sufficient credit to allow them to buy/build or lease and renovate suitable permanent facilities by themselves.

This paper elaborates a facility planning model according to which charter schools can maximize their chances of succeeding in the effort to secure permanent facilities. This model incorporates the following elements:

- *Facility Feasibility*--The scale and quality of project charter schools can and should realistically aim to accomplish;
- *Occupancy Cost*--The level of total facility cost (including rent or mortgage payments, taxes, and utility, maintenance, and building operation costs) charter schools can and should bear; and
- *Credit Standards*--Key financing and operating criteria that charter schools must be able and willing to meet to acquire permanent facilities through either leases or mortgages.

The paper also includes a summary of leading facility financing arrangements currently in use by charter schools. Finally, the paper presents recommendations for enhancing charter school facility financing alternatives to benefit more charter schools and to advise prospective facility financing providers.

Planning Model

Facility Feasibility

What are the essential characteristics of feasible charter school facility projects, regardless of whether they entail new construction, or renovation or expansion of an existing structure?

Given their current level of public funding, charter schools have little choice but to aim for *utterly basic* permanent facilities. To any charter operator who already has gone through the process of opening a school, this is not news. Aiming for more than safe, adequate, minimally appointed educational space in which students can be taught comfortably is not feasible for most charter schools from the standpoints of either cost or community politics.

"Utterly basic," however, does not imply simple in design or inexpensive. Like any other public school, a charter school must meet minimum life safety standards and be secured against hazardous materials. A suitable, permanent charter school facility also must meet reasonable size and space utilization standards. Based on the authors' experience designing and implementing charter school facility projects in five states, the minimum standards shown in the following table are the least a charter school should meet for its facility to be considered a suitable elementary school. The maximum standards shown are the most a school should seek to meet; beyond these, the facility's size and space utilization are no longer cost-effective.

Prototype Elementary School Facility Design Characteristics

Feature	Minimum	Maximum
Life Safety Standards	Fully sprinklered, medium renovation of an existing building	Fully sprinklered, Type 2 (new) construction
Building Standards	Compliance with BOCA* National Building Code	Compliance with local building code, if more stringent than BOCA's
Average Total Building Space Per Student	80 gross square feet	115 gross square feet
Average Regular Classroom Space Per Student	36 net square feet	70 net square feet
Educational Space as a % of Total Building Space	45%	60%
Average Dedicated SPED Space Per Student	1 square foot	5 square feet
Average Indoor Recreational Space Per Student	7 square feet (not less than 1,800 square feet in total)	9 square feet (not less than 1,800 square feet in total)
Building "Footprint" Size	21,600 Square Feet	Dependent on availability of useable land
Building Height	1 Story	Dependent on availability of useable land

* Building Officials and Code Administrators International, Inc.

The above standards set general parameters for a building design that maximizes what we call the facility's "revenue-generating" space (i.e., classroom space in which students can be seated for regular teaching) while providing minimally over the long term for other essential school activities such as physical education and special education.*

* Charter schools located in temporary spaces (e.g., church basements, storefronts, off-season resort motels, and even old Elks Lodges) must forego dedicated libraries, individual instructional areas, multi-purpose and administrative rooms, indoor and outdoor recreation/play areas, and other features that can be considered minimally "standard" for permanent school facilities. In the authors' experience, 80 gross square feet of facility space per student and 36 net square feet of classroom space per student are the least a facility must have to be able reasonably and legally to accommodate such "standard" features.

When planning a facility, charter school operators need to consider the scheduling and outfitting of classrooms to maximize their utilization. Classroom space can be made more flexible at low cost through the use of moveable room dividers and furniture. To minimize the use of precious space for non-teaching activities, the building design also should incorporate multi-use offices, conference rooms and media areas. Other indispensable design techniques for maximizing revenue-generating space include use of multi-purpose gymnasiums, cafeterias, and auditoriums, and provision for food service in classrooms themselves.

In addition to maximizing their facility's revenue-generating space, charter school operators should minimize special structural flourishes and non-standard architectural features that later would make the building more difficult or expensive to adapt to another use. Doing this not only simplifies and reduces the cost of construction, but it also makes it easier to convince prospective backers that the facility could be converted to another use in the future should it cease to be needed as a school. (From a financial backer's standpoint, this mitigates the risk that the facility would become a "white elephant", a single-purpose building with narrow market appeal.) For this reason, the sizes of the building's structural bays, floor heights, window spacing, and door openings should adhere to generic standards that fit other common institutional property uses, such as apartment housing or commercial offices.

Ideally, a charter school facility should be designed not only to accommodate the school's educational program, but also to allow for secure, cost-effective use of the facility by paying outside groups when the school is not in session. For example, an optimally designed charter school facility should have separate entrances to multi-purpose spaces, as well as secure interior zones that can be closed and locked when other parts of the building are in use by outsiders.

Occupancy Cost

What are the essential cost components of annual charter school facility occupancy? What portion of their operating revenues can and should charter schools pay each year for a permanent facility?

Occupancy Cost Components

The typical charter school operating budget has five required expenditure categories, including:

1) Classroom teaching
2) Special education
3) Food service
4) Health service
5) Facility occupancy

Most charter school budgets also include the category of student transportation, though free provision of student transportation by charter schools themselves is not required in many states.

Not all charter school budgets are organized according to these five or six categories, but virtually all expenditures a typical school makes can be assigned to one of them, including so-called administrative expenditures. We are concerned here exclusively with the category of facility occupancy costs, which includes much more than the "Rent" or "Mortgage" line items charter schools may show on their budgets.

The following table presents an itemization of the main costs a charter school likely will have to pay (in some form) to occupy a permanent facility.

Standard Facility Occupancy Costs

Item	Description	Annual Amount Per Square Foot
Rent and/or Debt Service	Cost of the land and building purchased or used, *plus* landlord's or lender's cost of funds, lending charges, and risk premium for developing the property	Determined by local property values and availability (i.e., the actual real estate market), scope and timing of development project, construction costs, and interest rates
Real Estate Taxes*	Tariffs for local government services	$1.00 to $3.00
Utility Charges	Tariffs for electricity, gas, and water services	$1.00 to $2.00
Maintenance and Operating Costs	Cost of repairs, preventive maintenance, cleaning, and reserves	$2.00 to $3.00
Total		**Rent or Debt Service *plus* $4.00 to $8.00**

* Charter schools able to lease facilities from public-sector owners (e.g., a local school district or a state government agency) normally can avoid paying real estate taxes, either directly or as a pass-through cost. In addition, as public or non-profit entities themselves, charter schools able to buy their facilities outright may be exempt from paying real estate taxes. Charter schools may be exempt from sales tax on materials and equipment too if they lease their facilities and contract directly for tenant improvements. Otherwise, charter schools leasing facilities from private landlords normally will have to pay all property and sales taxes as part of the *total* rent.

For the purpose of developing the planning model, we have roughly quantified those occupancy costs we believe cannot be significantly changed by facility design or school management choices. Taxes, utility charges, and maintenance and operating costs generally will be determined by local market conditions and not be amenable to more than temporary, marginal reduction by management actions. As long as a charter school is to be located in a particular municipality or regional market, its operators will have to live with the endemic charges.

External, location-determined costs notwithstanding, by keeping the size and appointments of its facility utterly basic, as described above, a charter school's *total* occupancy cost can be kept within reasonable bounds. Whether the school's occupancy cost can be minimized enough to make a suitable permanent facility affordable, however, depends primarily on public funding levels and property development costs.

Maximum Occupancy Cost

For a charter school to be staffed, equipped and supplied at a level at least comparable to that of a regular public school operating in the same community, we estimate that no less than 75% of its total annual public funding must be devoted to essential academic and support activities performed within and outside the walls of the facility, including classroom teaching, special education, food service, health service, and student transportation.* This leaves a

* Urban Massachusetts school districts, such as Boston and Worcester, devote about 65% to 70% of their operating budgets to such *school* activities, the rest going to central office or district overhead. Charter schools should be able to bring *at least* the same level of resources to their classroom programs using 75% of operating revenues.

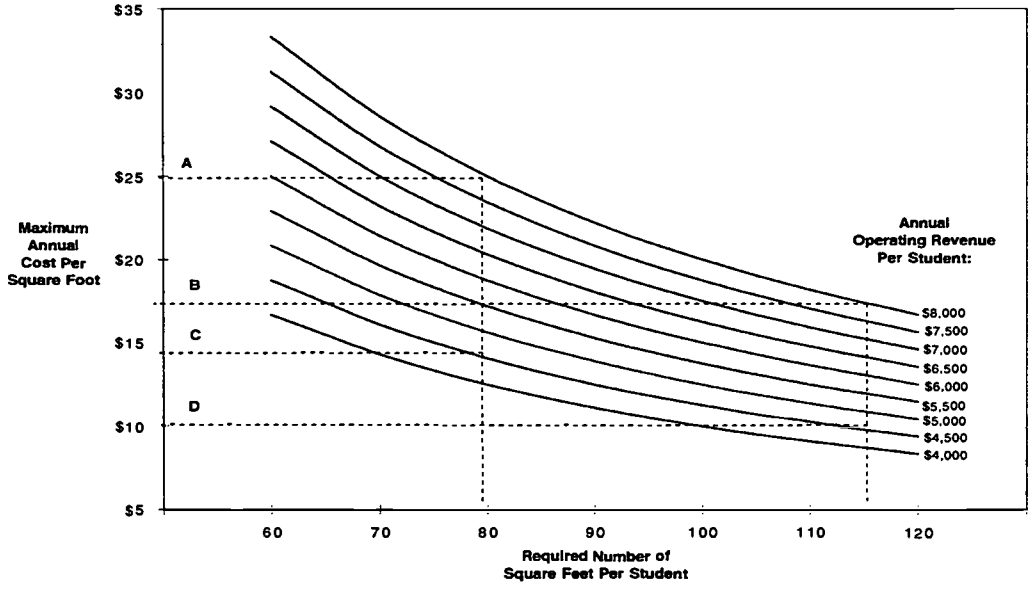
maximum of 25% of operating revenues to devote to "the walls" themselves, including their acquisition or construction, accompanying taxes, maintenance and operation, and basic utilities.

If *all* the occupancy costs a charter school must bear to have a suitable permanent facility in a given real estate market *cannot* be limited to 25% of annual operating revenues, then the school's operators must settle for a facility design closer to the minimum parameters shown earlier (to reduce construction, operating, and utility costs), seek to locate the facility in a less expensive property market (to reduce acquisition and tax costs), or both. The only other alternative is to deprive the school's educational program of operating funds needed to maintain resource levels comparable to those of other public school programs.

Facility Affordability

All other things being equal, charter schools operating in school districts where public education funding is higher will be able to afford marginally more space at incrementally higher occupancy costs. Holding school enrollment constant, this relationship is shown in the graph below.

Charter School Occupancy Cost
As A Function Of
Available Revenue And Space Requirements



The curves displayed on this graph denote the upper bounds of what charter schools can spend annually on occupancy of a permanent facility without depriving their educational programs of precious resources needed to be competitive with regular public schools. Each curve shows the maximum latitude a charter school receiving a certain level of annual operating revenue has in trading off between facility space (x-axis) and *total* occupancy cost (y-axis).

For example, the average charter school located in Connecticut--where annual operating revenue per student for the school would approximate $8,000--could afford to pay no more than $25.00 per square foot in total annual facility occupancy costs for the minimum amount of space needed, 80 square feet per student. (Note horizontal dotted-line A.) For the maximum amount of space it should use, 115 square feet per student, the Connecticut school could afford to pay no more than $17.50 per square foot in total occupancy costs. (Note horizontal dotted-line B.)

What does this mean in terms of the typical charter school's "Rent" or "Mortgage" budget line item? In Connecticut, real estate taxes, utility charges, and facility maintenance and operating costs run high and would be about $6.00 per square foot. As a result, the Connecticut charter school likely would be able to afford no more than $19.00 per square foot in annual *property rent or mortgage payments alone* for 80 square feet of facility space per student. If it sought as much as 115 square feet per student, the Connecticut school probably could not pay much more than $11.00 per square foot per year in rent or debt service for its facility space.

By comparison, a charter school located in Arizona--where annual operating revenue per student would approximate only $4,500--could afford to pay only about $14.00 per square foot in total annual occupancy costs for 80 square feet of space per student (Note horizontal dotted-line C.), and no more than $10.00 per square foot for 115 square feet per student (Note horizontal dotted-line D.). Fortunately for the Arizona charter school, local taxes, utility charges and other facility costs would be only about $4.00 per square foot. The Arizona school thus would be able to afford almost $10.00 per square foot in annual rent or debt service for 80 square feet per student, and approximately $6.00 per square foot for 115 square feet per student.

The following table presents general estimates of the maximum total occupancy cost and the maximum rent or mortgage payment a charter school could afford annually for 80 and 115 square feet of facility space per student in states where charter schools currently are concentrated.

Estimated Total Charter School Occupancy Costs And Rent Or Mortgage Payments

State	Annual Charter School Operating Revenue Per Student (a)	Approximate Annual Facility R/E Taxes, Utility Charges, and Maintenance and Operating Costs Per Square Foot (b)	For 80 Square Feet Per Student:		For 115 Square Feet Per Student:	
			Maximum Annual Charter School Occupancy Cost Per Square Foot (c)	Maximum Annual Charter School Rent or Mortgage Payment Per Square Foot (d)	Maximum Annual Charter School Occupancy Cost Per Square Foot (c)	Maximum Annual Charter School Rent or Mortgage Payment Per Square Foot (d)
New Jersey	$9,786	$7.98	$30.58	$22.61	$21.27	$13.30
Connecticut	$7,955	$6.01	$24.86	$18.85	$17.29	$11.28
Pennsylvania	$7,168	$5.04	$22.40	$17.36	$15.58	$10.54
Delaware	$6,944	$4.47	$21.70	$17.23	$15.10	$10.63
Minnesota	$6,928	$4.72	$21.65	$16.93	$15.06	$10.34
Massachusetts	$6,925	$5.25	$21.64	$16.39	$15.05	$9.81
Wisconsin	$6,621	$5.26	$20.69	$15.43	$14.39	$9.13
Washington, DC	$6,306	$5.40	$19.71	$14.30	$13.71	$8.30
Michigan	$6,171	$5.11	$19.28	$14.17	$13.42	$8.30
Florida	$5,415	$4.51	$16.92	$12.41	$11.77	$7.26
Illinois	$5,405	$5.28	$16.89	$11.61	$11.75	$6.47
North Carolina	$5,246	$4.86	$16.39	$11.53	$11.40	$6.54
Texas	$5,168	$5.04	$16.15	$11.11	$11.23	$6.20
Colorado	$5,086	$4.69	$15.89	$11.20	$11.06	$6.36
California	$4,927	$5.76	$15.40	$9.64	$10.71	$4.96
South Carolina	$4,659	$4.44	$14.56	$10.12	$10.13	$5.69
Louisiana	$4,479	$3.87	$14.00	$10.13	$9.74	$5.87
Arizona	$4,427	$4.00	$13.83	$9.83	$9.62	$5.62

Notes: (a) Based on aggregate 1996-1997 state education expenditures and pupil enrollments.

(b) Based on cost-of-living indices compiled by Boyer and Savageau in the *Places Rated Almanac* (Prentice Hall: New York).

(c) Calculated as follows: 25% of Operating Revenue Per Student/80 or 115 Square Feet of Facility Space Per Student.

(d) Calculated as follows: Occupancy Cost Per Square Foot - Facility Costs Per Square Foot.

Whether located in states where charter school operating revenue is high--such as New Jersey and Connecticut--or in states where it is low--such as Louisiana and Arizona--charter schools clearly cannot afford spacious facilities. Neither can they afford grandly appointed ones. Property taxes, utility charges, and facility maintenance and operating costs can consume from 21% (in Delaware) to 37% (in California) of a charter school's recommended maximum annual occupancy cost, leaving an extremely tight budget for actual space acquisition and renovation or construction. As the next table shows, local renovation/construction costs will consume a large portion of this tight budget, even if a school's operators rent or buy only the minimum amount of facility space and adhere to the utterly basic design standard described earlier.

Estimated Composition Of
Charter School Rent Or Mortgage Payments

State	Estimated Facility Renovation/ Cunstructiun Cost Per Square Fout (a)	Minimum Aunual Renovatiun/ Construction Debt Service Per Square Foot (b)	For 80 Square Feet Per Student:		For 115 Square Feet Per Student:	
			Maximum Annual Charter School Rent or Murtgage Payment Per Square Fuot (c)	Maximum Annual Raw Space Rental ur Purchase Cost Per Square Foot (d)	Maximum Annual Charter School Rent or Murtgage Payment Per Square Fout (c)	Maximum Annual Raw Space Rental ur Purchase Cost Per Square Foot (d)
New Jersey	$66.00	$7.64	$22.61	$14.97	$13.30	$5.66
Connecticut	$63.60	$7.36	$18.85	$11.49	$11.28	$3.93
Pennsylvania	$60.00	$6.94	$17.36	$10.41	$10.54	$3.60
Delaware	$59.70	$6.91	$17.23	$10.33	$10.63	$3.72
Minnesota	$63.60	$7.36	$16.93	$9.57	$10.34	$2.98
Massachusetts	$66.00	$7.64	$16.39	$8.76	$9.81	$2.17
Wisconsin	$57.00	$6.60	$15.43	$8.83	$9.13	$2.53
Washington, DC	$57.00	$6.60	$14.30	$7.71	$8.30	$1.71
Michigan	$55.80	$6.46	$14.17	$7.71	$8.30	$1.84
Florida	$51.60	$5.97	$12.41	$6.44	$7.26	$1.29
Illinois	$66.00	$7.64	$11.61	$3.97	$6.47	($1.17)
North Carolina	$45.00	$5.21	$11.53	$6.33	$6.54	$1.34
Texas	$48.00	$5.55	$11.11	$5.56	$6.20	$0.65
Colorado	$54.00	$6.25	$11.20	$4.95	$6.36	$0.12
California	$67.20	$7.78	$9.64	$1.87	$4.96	($2.82)
South Carolina	$45.00	$5.21	$10.12	$4.91	$5.69	$0.48
Louisiana	$49.80	$5.76	$10.13	$4.37	$5.87	$0.11
Arizona	$52.80	$6.11	$9.83	$3.73	$5.62	($0.49)

Notes: (a) Based on 1997 national construction cost indices for medium renovation projects prepared by R. S. Means, Inc. Such projects normally entail modification and partial replacement of major building systems (e.g., interior partitions, mechanical systems, electrical and lighting systems, plumbing systems, and vertical transportation systems), as well as hazardous materials abatement. Medium renovation projects usually do not include exterior renovations, window replacement, roof replacement, or playground construction and other site improvements.

(b) Assumes 15-year term financing at 8.5% interest rate.

(c) Taken from preceding table entitled "Estimated Total Charter School Occupancy Costs and Rent or Mortgage Payments".

(d) Calculated as follows: Rent or Mortgage Payment - Renovation/Construction Debt Service.

The appearance of absurdly low and even negative raw space rental/purchase cost numbers in the preceding table is *not* a mistake. This result indicates that--given the expected cost of renovation/construction and the level of public funding for charter schools in states such as Illinois, California and Arizona--charter schools will not be able to afford suitable permanent facilities in these areas without substantial supplemental funding, property acquisition and construction deals priced significantly below local market rates, or both.*

* This prediction is borne out by results to date. In Chicago, four of the first ten charter schools authorized in January 1997 did not open as scheduled for lack of affordable facility space. In California, almost all charter schools are "conversion" schools, which are former regular public school *buildings* that have been converted to charter schools. And in Arizona, of that state's approximately 210 charter schools 36% are "district-sponsored" (analogous to California's "conversion" schools, which receive existing public school buildings along with their charters), and more than 50% of the remainder are in facilities estimated to be comprised of eight or fewer classrooms.

While reducing space requirements to the minimum and hewing to a basic (but safe and legal) design standard are necessary steps for a charter school to take to have an affordable facility, they will not be sufficient in most places. In particular, because the typical charter school's space acquisition and construction budget is so demonstrably tight, the school likely will not be able to afford the cost of raw space rental or purchase (e.g., annual rent under a so-called "triple net" property lease) if the debt service it must pay (either indirectly through a lease or directly through its own borrowing) to cover the initial facility renovation or construction cost is too high. Thus, in addition to settling for a small, simple space as its permanent facility, the typical charter school must strive aggressively to minimize its expected debt service payments. To do this without special assistance, the school will have to meet certain essential credit standards, but even then it still may not be able to afford a suitable permanent facility.

Credit Standards

Given a feasible facility project and generally affordable occupancy costs, what requirements must a charter school satisfy to finance its permanent facility through a lease or a mortgage?

The discussion so far has focused on the general characteristics of a charter school facility project that *could* happen if school operators' space and design requirements are limited and practical, and if endemic renovation/construction rates and occupancy costs are affordable. Because at this stage of their development nearly all charter schools have no financial assets other than their expected flows of public revenue, *whether and how* such a project actually comes to fruition depends on the willingness of third parties to finance it. These parties' willingness to finance a charter school facility project normally will be a function of the risks they judge to be inherent in the project, and the school's ability and willingness to pay them enough to accept those risks.

General Requirements

Charter schools cannot afford to pay third parties very much to finance their facilities in any case. It therefore behooves school operators to do all they can to minimize the apparent risks associated with their facility projects. The biggest of these from the standpoint of potential financial backers is that, after paying all other costs of operating a competitive program, a given charter school simply will not have enough revenue left over to make all its facility rent or mortgage payments on time. Beyond this primary concern, prospective backers also focus on the possibility that the school will lose its charter for failure to perform programmatically, because of changes in either the political environment or the fiscal fortunes of state and local governments that support charter schools, or as a result of mismanagement or malfeasance on the part of school operators.

As discussed above, by making frugal building design choices (to maximize a facility's feasibility) and finding the right local property market (to maximize the facility's affordability) in the first instance, a charter school's operators can substantially mitigate potential backers' concerns about excessive fixed program costs. Beyond this, they need to convince prospective backers of the amount and reliability of revenue that will flow to the school from *the backers' point of view*. In the authors' experience, this effort entails demonstrating clearly that a critical mass of facility space--at least 45%--will be used to seat students for classroom instruction, and that this revenue-generating space will be fully utilized. Moreover, if the financing of a charter school facility project is to extend beyond the term of the school's charter itself, the school's operators must be able to show why--given the school's educational program, external political climate, and management team and controls--charter extension or renewal is likely.

The following table summarizes what we believe are the minimum credit standards to be met by a charter school before it can credibly approach potential financial backers--including prospective landlords, lenders, and even grant makers--for support in securing a suitable, permanent facility.

Basic Charter School Facility Credit Standards

Design	Cost	Revenue
• Utterly basic facility design • Facility compliance with BOCA National Building Code • 80 square feet of facility space per student	• *Maximum* of 25% of annual operating revenue to be expended on facility occupancy	• *Minimum* of 45% of facility space to be built as classrooms • 100% utilization of educational space at 22.5 students per classroom on average • High probability of charter extension or renewal if financing to extend beyond charter term

Once approached, potential financial backers will need to satisfy themselves that the risks they would associate with a particular charter school facility project are indeed minimized. The following table presents the fundamental issues prospective backers are likely to raise. A school's operators will have to address these issues fully before their facility project will be financed and can proceed.

Credit Issues To Be Addressed with Charter School Facility Project Backers

Design	Cost	Revenue
• Is enough safe facility space available in the school's target community or at the school's planned site to accommodate expected enrollment and growth? • Can the planned facility be renovated/constructed to minimum required building and zoning standards without extraordinary measures? • Can the planned facility be renovated/constructed on a schedule that meets the school's needs?	• Can the school afford current and projected local market rates for the raw space it will need, given expected tax, utility and other occupancy costs it will have to pay too? • Can the school afford ordinary local construction rates, given facility design, building code, and zoning standards it must meet? • Can the planned facility be renovated/constructed on schedule without special work for which a premium must be paid?	• Is the school's expected enrollment growth sufficient to keep the facility fully utilized? • Will the school be able to deliver over time programmatic results good enough to maintain its enrollment and retain its charter? • If the facility ceases to be used as a school, can it be readily adapted to other uses that will provide a sufficient cash flow? • Can the school's operators manage the facility renovation/ construction project well enough to ensure completion on budget (according to the original design) and on time?

Because local conditions under which charter schools have to operate differ markedly from community to community, we cannot offer a formulaic response to the above questions that would assure the satisfaction of prospective financial backers of charter school facility projects. However, charter school operators can greatly increase the probability of success when they seek financing by:

1) Targeting at the same time several adjacent communities as their school's service territory to broaden the geographic area in which sufficiently large, affordable facility space options can be found, and from which current and future student enrollments can be attracted;

2) Allowing 2 to 4 months for negotiation and finalization of a satisfactory, affordable property lease or purchase arrangement;

3) Allowing 3 to 6 months more for the development of detailed construction plans, the securing of required local building permits and zoning approvals for *both* the planned school use and other likely potential uses to which the facility could one day be put, and for the bidding of all planned renovation/construction work to minimize contractor costs; and

4) Allowing another 6 to 12 months (depending on the extent of the work) for the actual renovation/construction work to be completed to avoid paying premiums for acceleration of the normal construction schedule.

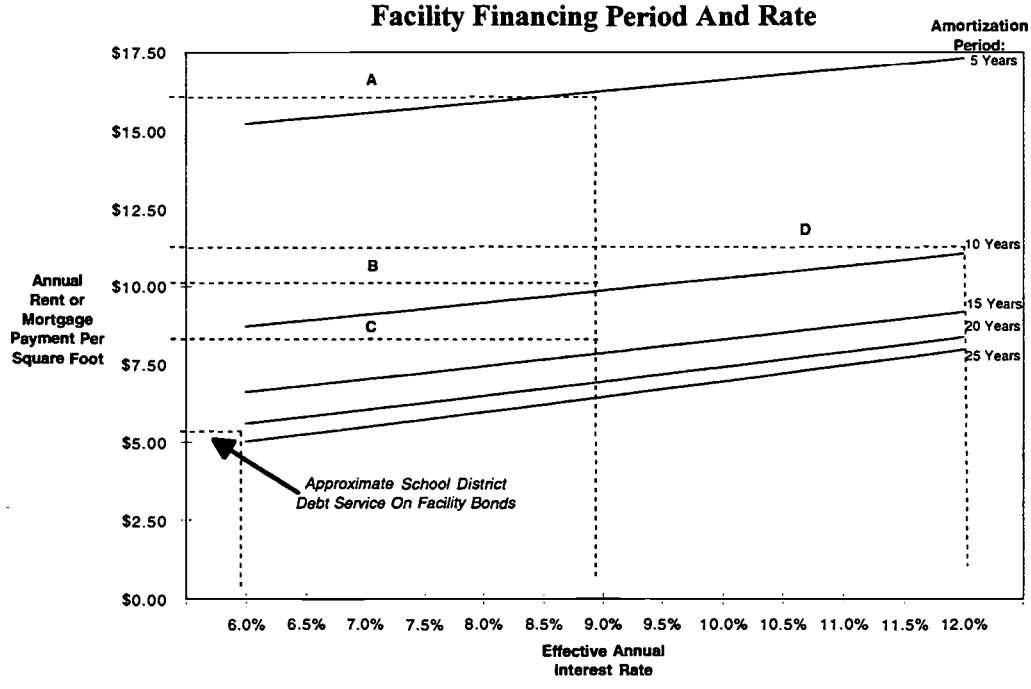
Key Financing and Operating Requirements

The point of attempting to meet the general credit requirements just discussed is not only to convince potential backers to finance a charter school facility project, but also to obtain the best possible terms for such financing. What should matter most to a charter school in this regard?

Financing Period. The most important objective for charter school operators in arranging facility financing, consistent with the basic credit standards presented above, is to minimize their school's effective annual building rent or debt service. Perhaps counterintuitively, school operators must be willing to accept a *high cost* of financing (i.e., the effective annual interest rate on project funds) in exchange for *more time* to repay the funds used for their facility projects. Securing the longest possible financing period for a project, even if a charter school must pay what might seem to be an exorbitant rate for the financing, can dramatically reduce the rent/debt service component of annual facility occupancy cost and provide the final margin the school may need to escape the "high rent/temporary space" trap.

To illustrate this point, the following graph shows the trade-off between cost of financing and length of repayment period for the "average" charter school in Massachusetts.

Average Massachusetts Charter School: Rent/Debt Service As Determined By Facility Financing Period And Rate



Assumptions: 1) Gross facility size of 21,600 square feet.
2) Expected facility renovation/construction cost of $1,425,600, or $66.00 per square foot.

As shown, if the school's annual cost of financing is fixed at 9.0%, its facility rent or debt service payment can be reduced nearly 40% by doubling the financing (or amortization) period from 5 to 10 years, and reduced 52% by tripling it to 15 years. (Note horizontal dotted-lines A, B, and C.) Conventional lenders (e.g., commercial banks) typically will charge more for allowing a longer financing period. Even so, the average Massachusetts charter school referred to in this example could pay a third more (i.e., at least 12.0%) for its financing in exchange for a 10-year amortization period and still reduce its annual facility rent or debt service by a third from what it would be at a cost of 9.0% for a period of 5 years. (Note horizontal dotted-line D.)

Their willingness to make the financing cost/repayment period trade-off notwithstanding, charter school operators many times already have been confronted by prospective backers with the discrepancy between the period of their school charters--which is at most 5 years in all chartering states but Arizona and the District of Columbia, where it is 15 years--and their requests for long financing amortization periods. In brief, few (if any) potential backers are willing to trust that any particular charter school will work as planned and qualify to have its charter--its license to operate--renewed at the end of the charter period. They want security against the possibility that the school's charter will *not* be renewed, and they want that security to be as tangible as possible.

Without significant collateral or financing guarantees, this issue is very difficult for charter schools to surmount, and none of the options for doing so is attractive. If a charter school's operators cannot afford a permanent facility without being allowed to amortize the cost of the project over a period greater than the normal charter term, *as last resorts* their options are:

- *Waiting*--Delaying the school's opening a year or more can allow its operators time to reduce the expected cost of their facility project further, identify financing alternatives that do not require security, and possibly attract charitable funding as equity for project financing. Or the school's operators could postpone active efforts to obtain a permanent facility until the school's operating record is well established and renewal of its charter assured. Such a postponement could last as long as three to five years. During this period, the school probably would have to be housed in substandard space, and its operators would need to focus on accumulating strong reserves to demonstrate the school's frugal operating philosophy.

- *Accepting "Balloon" Financing*--While able to make rent/debt service payments as though the financing period were longer than the charter period, at the end of the charter term the school still would have to repay the entire remaining obligation in one or several large "balloon" payments. To do this, the school would have to accumulate substantial reserves by the end of the charter term, which could be difficult in states and districts where charter school funding is low.

- *Paying a Very High Interest Rate*--In recognition of the fact that--at least at the time project financing is first provided--little tangible security is available against the possibility of a charter school ultimately failing to qualify for charter renewal, the school could agree to pay an unconventionally high interest rate for facility project financing to have a repayment period that extends beyond the regular charter term. Despite the nominally high cost, such a deal could yield an affordable annual rent or debt service that makes the project financeable when it otherwise would not be. (Consider, for example, that even if the "average" Massachusetts charter school were to agree to pay an interest rate as high as 23.5% on project financing amortized over 10 years, its required annual rent/debt service payments still would be less than those required for 5-year term financing at an 8.5% interest rate.)

School Enrollment. In addition to paying a high cost in exchange for a long financing period, a charter school's operators normally will have to commit to enrolling a minimum

Charter School Facility Financing Initiatives

To assess the efficacy of the planning model in preparing charter schools to seek financing for permanent facilities without special help, we contacted a number of facility financing providers throughout the country who either have experience working with charter schools or intend to enter this market soon. Selected results of this informal survey are presented on the following pages. For ease of reference, they have been compiled to show side-by-side (to the extent the information was reported) each provider's capitalization, basic credit requirements, project management requirements, and general proposed terms for financing charter school facilities. The information presented should not be construed in any way as the providers' firm eligibility requirements or terms of offer, which could vary greatly by facility project and local conditions.

Selected Charter School Facility Financing Providers' General Resources, Requirements, And Terms

Financing Source	Target State Market(s)	# of Facilities Financed	Largest Facility Financing Completed	Capitalization ($Millions):		Basic Credit Requirements:		
				Total	Amount Earmarked for Charter School Facilities	School Management	Minimum Rent/Mortgage Coverage Ratio	Reserves
Asset Backed Income Group, Inc. (Broker/ Intermediary to Private Capital)	Arizona, Florida, Massachusetts, Michigan, and Texas	5	$600,000	N/A	N/A	• Prefer private school conversions to charter schools, or schools led by administrators with public superintendent-level experience • Management team with good financial acumen and at least one year's experience operating the school • Team members' credit histories clean	Deal specific	N/A
BankBoston	Massachusetts; exploring other states on *ad hoc* basis	1	$4,000,000	$70,000	N/A	• Professional team with previous school management experience • Backed by strong capital (assets or commitments)	1.25	Deal specific
Community Development Financial Institution*	Large eastern state	3	$1,850,000 *total* lending on all charter school facility projects	$150	N/A	• Cohesive team with good community roots and reputation • Experience managing similar facility projects • Team members' credit histories free of major defaults • Strong, stable operating record, if school is already open	As low as 1.00, but deal specific	Sufficient to amass balloon payment, if required, by time due
Educational Development Corporation (EDC) (School Operator) and **Charter Development LLC** (Facility Financing Provider)	Michigan	8	$3,600,000	$22	$22	Must be provided exclusively by EDC	Deal specific	N/A
Equi-Mor Holdings, Inc.	Arizona, California, Colorado, Florida, Minnesota, and Texas; exploring other states on *ad hoc* basis	20 to 25	$3,200,000	$200	$200	• Team must include experienced school operators and fiscal managers • Team members' credit histories satisfactory • School's "story" must be coherent and sound	No more than 25% of gross revenues committed to facility financing	N/A

* Requested anonymity.

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number of students in their school to obtain backing for a permanent facility. This requirement also stems directly from prospective backers' ever-present concern about the amount and reliability of revenue that will flow to the school. Only a school that has a critical mass of enrolled students (along with a critical mass of revenue-generating space) will have public revenue flows sufficient to cover the expected rent/debt service payments and other occupancy costs of a permanent facility that meets the minimum standard.

Taking 21,600 gross square feet as the standard permanent facility "unit," the upper bound of the critical mass of students is 270 students per unit. The lower bound is a function of both expected annual operating revenue per student and market rates for property rent (or purchase) and construction in a given community. For example, consider again the "average" charter school in Massachusetts. The table below shows how the school's ability to afford a permanent facility increases steeply as it adds two classrooms (of 22.5 students each on average) at a time. With a minimum of 8 classrooms accommodating 180 students, the rent or debt service the school can afford is potentially high enough to allow the school to acquire a permanent facility. (Note the shaded cells in the table.)

Average Massachusetts Charter School:
Estimated Occupancy Cost Composition For
A One-Unit Facility At Different School Enrollments

Planned Student Enrollment	Expected Annual Operating Revenue	Recommended Maximum Annual Facility Occupancy Expenditure	Expected Annual Facility Taxes, Utility Charges, and Maintenance and Operating Costs:		Maximum Funds Available for Rent/Mortgage Payments:		Maximum Affordable Rent/Mortgage Payment Per Square Foot
			Amount	As a % of Annual Operating Revenue	Amount	As a % of Annual Operating Revenue	
45	$311,625	$77,906	$113,316	36%	$0	0%	$0.00
90	$623,250	$155,813	$113,316	18%	$42,496	7%	$1.97
135	$934,875	$233,719	$113,316	12%	$120,403	13%	$5.57
180	$1,246,500	$311,625	$113,316	9%	$198,309	16%	$9.18
225	$1,558,125	$389,531	$113,316	7%	$276,215	18%	$12.79
270	$1,869,750	$467,438	$113,316	6%	$354,121	19%	$16.39

At a size of 180 students, the school could afford a *maximum* of $9.18 per square foot in annual rent or debt service for a 21,600 square foot facility, provided it could acquire suitable raw space for about $1.50 a square foot and finance building improvements at a cost of 8.5% for 15 years. (While such a deal is not out of the question, it would be extremely uncommon in most local Massachusetts property markets today.) As its enrollment increased to 270 students, however, the school could afford more realistic levels of rent or debt service.

[Coincidentally, this optimal size range of 180 to 270 students for a school attempting to afford a permanent facility is apparently consistent with current views concerning the optimal school size for creating a strong community and promoting learning among both students and teachers. To summarize these views, no school should contain

more pupils than its principal can call by name, which for most school heads would indicate a group of about 250 students.*]

For the edification of potential financial backers, the critical mass of students can be identified precisely as the enrollments at which the school's expected operating revenue less its program and *non*-rent/debt service occupancy costs divided by its expected rent/debt service payment equals 1.20 or more. This number is called the rent/debt service coverage ratio, and, as shown in the next table, it will vary even within the optimal school-size range according to the financing terms the school finally obtains.

Average Massachusetts Charter School:
Rent/Debt Service Coverage Ratios At
Recommended Minimum And Maximum Enrollments

	Amortization Period (Years)	Effective Annual Interest Rate: @ 6.0%	@ 6.5%	@ 7.0%	@ 7.5%	@ 8.0%	@ 8.5%	@ 9.0%	@ 9.5%	@ 10.0%	@ 10.5%	@ 11.0%	@ 11.5%	@ 12.0%
Minimum Enrollment of 180 Students	5	0.60	0.60	0.59	0.58	0.58	0.57	0.56	0.56	0.55	0.55	0.54	0.54	0.53
	10	1.05	1.03	1.01	0.99	0.97	0.95	0.93	0.91	0.90	0.88	0.86	0.85	0.83
	15	1.39	1.35	1.31	1.27	1.24	1.20	1.17	1.14	1.11	1.08	1.05	1.03	1.00
	20	1.64	1.58	1.52	1.47	1.42	1.37	1.32	1.28	1.24	1.20	1.17	1.13	1.10
	25	1.83	1.75	1.68	1.61	1.54	1.48	1.43	1.37	1.32	1.28	1.23	1.19	1.15
Maximum Enrollment of 270 Students	5	1.08	1.06	1.05	1.04	1.03	1.02	1.01	1.00	0.99	0.98	0.97	0.96	0.95
	10	1.88	1.84	1.80	1.77	1.73	1.70	1.66	1.63	1.60	1.57	1.54	1.51	1.48
	15	2.48	2.41	2.34	2.27	2.21	2.15	2.09	2.03	1.98	1.93	1.88	1.83	1.79
	20	2.93	2.82	2.72	2.62	2.53	2.45	2.37	2.29	2.22	2.15	2.08	2.02	1.96
	25	3.27	3.13	2.99	2.87	2.75	2.65	2.55	2.45	2.36	2.28	2.20	2.13	2.06

Assumptions:
1) Annual operating revenue of $6,925 per student.
2) Gross facility size of 21,600 square feet.
3) Facility renovation/construction cost of $1,425,600, or $66.00 per square foot.
4) Annual facility taxes, utility charges, and maintenance and operating costs of $113,316, or $5.25 per square foot.

Compared to the 1.20 standard, the shaded coverage ratios are those most potential financial backers would find attractive. As indicated, the closer to an enrollment of 270 students the school can come, the more able it will be to bear high financing costs for any repayment period, and the more likely it ultimately will secure facility project financing.

* Boyer, E. (1995). *The Basic School: A Community for Learning*. Princeton, NJ: Carnegie Foundation for the Advancement of Teaching; and
Turney, D. (1996). "What I Learned: An Educational Perspective." *Journal of Curriculum and Supervision*, 11 (3), pages 276-280.

Selected Charter School Facility Financing Providers' General Resources, Requirements, And Terms

	Project Management Requirements:			Financing Terms:							
Financing Source	**Budget**	**Schedule**	**Construction Resources**	**Amortization Period (Years)**	**Balloon Payment Requirement**	**Pre-Payment Option**	**Security Requirement(s)**	**Cost of Funds**	**Ordinary Financing Charges**	**Risk Premium Charge**	**Total Cost**
Asset Backed Income Group, Inc. (Broker/ Intermediary to Private Capital)	Lender approves final project budget	Deal specific	Progress payments disbursed from escrow account; completion bond may be required	10 to 15	N/A	Allowed with no penalty	25% equity or approved co-signatory	N/A	3.0% to 4.0% added to project budget and included in total financing	N/A	10.0% to 11.0%
BankBoston	Lender approves final project budget, including all "hard" and "soft" costs	Deal specific, but rigorously applied once established	Lender may retain project reviewer at school's cost	• 20 to 25, but could be shorter depending on security or collateral quality • Financing done as 5-year loan to match charter period	Payment required at end of charter period	If floating rate financing, no pre-payment penalty charged; if fixed rate, penalty may be charged	• Mortgage assumed; otherwise, first position on facility and other tangible assets • Financing must be fully collateralized or guaranteed	Market-based rates (e.g., LIBOR)	• 1.0% to 3.0%, depending on credit risk as determined by lender • 1.0% origination fee	N/A	Cost of funds *plus* 1.0% to 3.5%
Community Development Financial Institution*	Lender approves final project budget, including all "hard" and "soft" costs	Completion in 12 months or less	Lender approves construction bid and construction manager selection	• 15 to 25 for secured loans • 5 or less for unsecured loans	Payment required for unsecured loans at end of charter period	Allowed for secured loans only	• Collateral or guarantee required if management team is not considered strong enough • Assignment of public revenues preferred if loan is unsecured	5.0% to 6.0%	• 4.5% to 6.5% for secured loans • 6.5% to 10.5% for unsecured loans	• 0.0% for secured loans • 10.0% to 14.0% for unsecured loans	• 9.5% to 12.5% for secured loans • 21.5% to 30.5% for unsecured loans
Educational Development Corporation (EDC) (School Operator) and **Charter Development LLC** (Facility Financing Provider)	Charter Development requires facility design at cost below $60.00 per square foot	Typically ~18 months, but deal and site specific	Charter Development selects architect and construction manager	• 15 for secured facility transactions • All deals fully amortized	N/A	Allowed with no penalty	40% equity	Market-based rates	N/A	N/A	7.0% to 8.0%
Equi-Mor Holdings, Inc.	Lender approves final project budget, including all "hard" and "soft" costs	Minimum of 8 to 9 months for completion	Lender approves construction manager selection; progress payments disbursed from escrow account	• Up to 25 for secured facility transactions • All deals fully amortized	N/A	Allowed, but 3.0% to 4.0% of outstanding balance may be charged as penalty	• If more than $250,000, financing must be collateralized or guaranteed • If financing is less than $250,000, security may be waived	~9.0%	0.50% to 1.25%	N/A	9.50% to 10.25%

* Requested anonymity.

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Selected Charter School Facility Financing Providers' General Resources, Requirements, And Terms

Financing Source	Target State Market(s)	# of Facilities Financed	Largest Facility Financing Completed	Capitalization ($Millions):		Basic Credit Requirements:		
				Total	Amount Earmarked for Charter School Facilities	School Management	Minimum Rent/Mortgage Coverage Ratio	Reserves
Illinois Facilities Fund (IFF) (Community Development Financial Institution Working Under Contract for the Chicago Public Schools)	Chicago, Illinois only	2	$540,000	$2	$2 (Revolving loan fund capitalized by the Chicago Public Schools)	• Evidence of basic fiscal controls (e.g., periodic financial statements) • Evidence of management team's financial acumen • IFF must approve school's budgets and spending plans	1.10	N/A
Massachusetts Development Finance Agency	Massachusetts	1	$12,200,000	~$50	N/A	• Professional team with previous school management experience • Backed by sufficient capital (assets or commitments)	1.25	Deal specific
Minnesota Building Lease Aid for Charter Schools (State Program for Leasing Existing Buildings Only)	Minnesota	24	~$60,000 to $100,000	~$3	~$3	• School must already be chartered and have negotiated a final lease agreement • Non-rent occupancy costs (e.g., custodial services) are not eligible for aid	N/A	N/A
National Industries, Inc. (Broker/ Intermediary to Private Capital)	Colorado, Massachusetts, Michigan, North Carolina, New Hampshire, New Jersey, and Rhode Island	2	$250,000	N/A	N/A	• Professional team with previous school management experience • Backed by sufficient capital (assets or commitments)	Deal specific	As much as six months' rent reserve may be placed in escrow

* Requested anonymity.

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Selected Charter School Facility Financing Providers' General Resources, Requirements, And Terms

	Project Management Requirements:			Financing Terms:							
Financing Source	**Budget**	**Schedule**	**Construction Resources**	**Amortization Period (Years)**	**Balloon Payment Requirement**	**Pre-Payment Option**	**Security Requirement(s)**	**Cost of Funds**	**Ordinary Financing Charges**	**Risk Premium Charge**	**Total Cost**
Illinois Facilities Fund (IFF) (Community Development Financial Institution Working Under Contract for the Chicago Public Schools)	IFF approves final project budget, including all "hard" and "soft" costs	Deal specific; typically, completion in 8 months or less	IFF either provides construction management, or has say in school's choice of manager	• 15 secured loans • 5 to 10 for unsecured loans	Payment required at end of charter period	Allowed with no penalty	Mortgage assumed; otherwise, first position on facility and other tangible assets	N/A	5.0%	N/A	5.0%
Massachusetts Development Finance Agency	Lender approves final project budget, including all "hard" and "soft" costs	Feasible opening by start of school year; otherwise, as quickly as possible	Lender approves construction bid and construction manager selection, and retains project reviewer at school's cost	10 to 29, but deal specific	Deal specific	Allowed with no penalty	• 10% to 20% equity, depending on project • Third-party guarantee also may be required	~6.0% to 7.0%	• 1.0% origination fee • 0.5% commitment fee	N/A	Deal specific; at least 7.5%
Minnesota Building Lease Aid for Charter Schools (State Program for Leasing Existing Buildings Only)	State Department of Children, Families and Learning approves final lease for reasonableness	Applications accepted only after completion of school's lease agreement	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	Maximum aid: 80% of *approved net lease amount*
National Industries, Inc. (Broker/ Intermediary to Private Capital)	NI must agree to final project budget; may require up-front payment of site work and "soft" costs	Minimum of 6 to 7 months for completion preferred	School must use Pope Building Systems, a turn-key provider of modular educational space	• Coterminous with charter term for operating lease at taxable interest rate • Deal specific for lease/ purchase arrangement	N/A	N/A	• Third-party guarantee of lease payments must be provided • Debt service reserve may be escrowed • NI retains title to facility	N/A	$5,000 to $10,000 for initial facility design work	N/A	• 6.0% to 7.5% for tax exempt facility lease/ purchase arrangement • 8.0% to 9.0% for operating lease of modular facility

• Requested anonymity.

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Conclusions And Recommendations

The following conclusions and recommendations--vis-à-vis increasing the likelihood of charter schools standing on their own in acquiring permanent facilities--are derived from the planning model presented above and tempered by the preceding survey information. One set is directed to charter school operators themselves, a second set to policy makers and executives in a position to influence the regulatory constraints under which charter schools operate, and a third to commercial lenders and other potential private sources of charter school facility financing.

For Charter School Operators

#1 In Seeking A School Site, Cast A Broad Net And Allow Time To Haul It In.

Because of the difficulty involved in actually finding developable land or a building located in a place where a charter school can keep its occupancy costs to a maximum of 25% of operating revenues, school operators should--within reason--emphasize finding a community or neighborhood that fits the school's economics rather than trying to force the school's economics to fit a particular venue. Ultimately, this may mean siting the school in a different community than the one originally targeted, as well as acquiring multiple sites for the school as it grows.

Once a prospective site is identified, school operators should take time to evaluate it carefully to ensure that it truly requires no more than a medium renovation (if it has an existing structure), or that it can be built new for an affordable cost given local construction rates and charter school funding levels. In particular, the possible presence of hazardous materials needs to be thoroughly assessed, especially at sites located in old urban communities. If the site economics pessimistically estimated do not allow the school to keep its occupancy costs within 25% of operating revenues, the site should be rejected and another sought no matter how long it may take. (In this regard, school operators should keep several prospective sites "in play" until final lease or purchase terms are agreed on one. Doing this provides a hedge against the likelihood that any particular deal will "fall through" before it is concluded, and increases bargaining power in negotiations with prospective facility landlords and sellers.)

In addition, school operators should take the long view when seeking a school site. From the start, they should aim to buy their school's facility because of tax and other benefits ownership can bring. For this reason, even if a permanent facility must be leased at first to be affordable, the school's operators should strive to have a feasible purchase option included in the lease terms.

#2 In Designing A School Facility, Adopt The Minimum And Stick To It.

As implied by the planning model presented above, charter school operators have little choice but to embrace a simple, minimalist design for their facility economics to work. Above all, they need to keep constantly in mind the imperative to maximize a facility's revenue-generating space. In practice, this means sticking to strict limits on the amount of non-classroom space they include in the facility design even in the face of strong pressure to do otherwise from school constituents.

Charter schools normally are not required to meet physical and programmatic construction requirements that apply to regular public school facilities. Ironically, because charter schools are *not* eligible for public capital funding, they are free to design and construct more efficient facilities than regular public schools are permitted to do. This flexibility allows charter schools to consider facility alternatives that regular public schools typically shun--such as vacant commercial and retail space in locations for which demand for these uses has diminished--but which may well be suited to development as low-cost, permanent facilities. Moreover, such space could be readily adapted to non-school uses in the future, which potentially would enhance its value in the eyes of prospective financial backers.

Charter schools also have the flexibility to use creative, unconventional approaches to providing adequate but low-cost space for physical education and other activities outside of the classroom. Siting charter school facilities near other public educational and recreational facilities (e.g., libraries, parks, playgrounds, skating rinks, swimming pools, etc.) and arranging partnerships with community organizations (e.g., YMCAs, community colleges, adult education programs, etc.) that have complementary facilities (e.g., auditoriums and gymnasiums) not normally in use during school operating hours are just two such approaches. In this way, charter school operators can and should consider facility sites and supplementary space that regular public schools would overlook, especially when aiming to locate facilities in the "built environment" of older cities.

Finally, in designing their school's facility, charter school operators should evaluate planned class sizes, teaching methods, and educational program scheduling. Fully envisioning the way in which the facility will be used on a daily basis is critical to developing a cost-effective building layout.

#3 *In Planning School Growth, Start At An Optimal Size And Take A Few Years To Occupy A New Building Fully.*

To improve their school's prospects of qualifying for facility financing, a charter school's operators should plan to open the school with an initial enrollment in the optimal school-size range described earlier. Doing this will provide the school from the start with a minimally sufficient cash flow to cover its expected rent/debt service.

If possible, however, a school should avoid filling its facility to capacity on opening day to reserve enough space for several years of normal growth. This is a tricky balance to strike for any charter school operating on a tight budget. The primary goal is to keep the school's revenue-generating space as a proportion of total facility space at or above the 45% threshold.

One possible approach to striking this balance for the average Massachusetts charter school is shown in the following table.

Average Massachusetts Charter School: Sample School Growth Plan

School Year	Grades to Be Enrolled	# of Classrooms	Educational Space Requirement (Square Feet)	Non-Educational Space Requirement (Square Feet)	Total Space Requirement (Square Feet)	# of Students	Average Space Per Student (Square Feet)	Educational Space as % of Total
#1	K-3	8	8,050	8,370	16,420	180	91	49%
#2	K-4	10	9,900	9,110	19,010	225	84	52%
#3	K-5	12	11,750	9,850	21,600	270	80	54%

Following this plan, the school would enroll 180 students when the school first opens, then increase the enrollment by 45 students a year until the facility's recommended capacity is reached. In this way, the school could enjoy up to three years of growth spanning six grade levels without having to require any of its students to leave for lack of facility space. At that point, the school's operators would need to seek a second facility "unit" if they intended to have their program go beyond the fifth grade. During the three years following school opening, they would have time to consider and pursue options (e.g., a second school site) for growth. By comparison, if the school enrolled a full 270 students upon opening, its oldest students would have to leave after just one year unless the school acquired a second facility unit by its second year--a difficult prospect at best--or ceased admitting new students right after opening--an undesirable alternative.

The school growth plan presented above is not the only one that could buy a charter school time to grow normally while still living within its means. But it does illustrate how

tightly planned any charter school's facility use will have to be if it is to afford a permanent facility *and* grow without disruption in the short term.

#4 ***In Negotiating Financing Terms, Be Prepared To Pay For Time.***

As indicated in the planning model discussion, charter school operators should not dismiss unconventional financing as "too expensive" if it can be used to acquire a suitable permanent facility that would otherwise be unaffordable. It is highly optimistic to expect that a newly-formed charter school will qualify for facility financing at preferred conventional-lending terms unless the school has an established financial benefactor whose credit can be substituted for the school's own.

In the absence of unusual circumstances, then, the charter school will have to pay a premium for its facility financing. To do this, the school's operators should attempt to utilize all the benefits of a longer lease term or mortgage amortization period in spite of the marginally higher financing cost that will result. Furthermore, they should endeavor to obtain pre-payment rights on their financing to allow them to seek so-called "take-out" financing at more favorable rates and terms later once the school is proven to be a successful concern.

#5 ***In Constructing The School, Allow Ample Lead Times.***

Perhaps the most important thing a charter school's operators need to keep the cost of a facility project affordable is time. Attempting to fit the facility project schedule to a short school opening schedule will drive up both renovation/construction and financing costs considerably. For this reason, a school's operators should allow themselves at least 11 months--and if possible as many as 22 months--to conceive, negotiate, finance, and complete a charter school facility project. If it is imperative that their school formally open sooner than such a schedule would allow (e.g., because award of the school's charter is contingent upon opening by a certain date), they should drastically limit the size of the school at opening to what will fit in the most conveniently located, cheapest "as-is" rental space available.

Identifying cost-effective school sites is not a simple process, and prospective sites that are affordable on paper may not be suitable for safety, health, or local political reasons. Proper evaluation of each potential site's physical features and economics is very time consuming. Charter school operators therefore should allow an ample period to compile a list of site alternatives and evaluate them adequately to maximize their chances of selecting a cost-effective site in the first instance. Once such a site is chosen and construction initiated, school operators should avoid rushing the work to completion. Doing this will only negate their careful effort to pick a suitable site the school can afford, ultimately requiring the school to pay more for less in completing its facility.*

For Policy Makers

#1 ***Make Charter Terms Longer.***

Not all charter schools should be expected to qualify for permanent facility financing, just as not all charter schools will have strong enough educational programs to merit continued operation. However, those schools that are able to demonstrate the attractiveness and effectiveness of their programs--both academic and financial--should be given more to work with than they have now to qualify for facility financing.

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* Even if a higher price is paid to complete facility construction/renovation early, there is no guarantee that the project actually will be finished early. Inflexible lead times for ordering, manufacturing, and delivering required construction materials must be allowed. In addition, using additional labor in the form of extra construction shifts or overtime work decreases productivity, accelerating the project schedule very little for the extra cost incurred.

The regulatory change that would make the biggest difference to charter schools in this regard is lengthening of the charter term. This is now only five years in most states. If a term of 15 or even 10 years were authorized instead, worthy charter schools would be placed in a much stronger position to seek and obtain permanent facility financing *at no additional public cost*. Such a regulatory change would give potential financial backers, including even conventional commercial lenders, confidence that charter schools are here for the long term and not just a short-term education-reform experiment. Moreover, by holding out the prospect of a planning horizon that would be long enough to make low-cost *and* long-term permanent facility financing feasible, this change would encourage charter school operators to start and increase the size of their schools at a measured pace.

The quality check that would apply under a longer charter term is the same one that applies now. Charter schools would still be held accountable to established state standards, and failure to meet those standards could and should result in charter revocation. To make these standards meaningful for prospective financial backers of charter school facilities, state regulators should promulgate the circumstances under which charter revocation would occur, as well as the process, period, and terms of corrective action that may be taken when such circumstances arise. Such an approach would greatly reduce uncertainty for outside observers of the charter revocation process. In turn, a more transparent process would enable potential financial backers to develop their own criteria for assessing, and benchmarks for managing, the risk of charter revocation should they provide facility financing to a charter school.

As an interim option--until a formal lengthening of the charter term can be finalized--state agencies that oversee charter schools should consider providing written statements of confidence regarding a school's prospects for charter renewal when it is evident the school is performing well enough to justify this. Such a statement, while not as good as actual charter renewal, still would serve to reduce uncertainty for potential financial backers and strengthen the position of a charter school looking for affordable facility financing.

#2 *Provide Partial Guarantees For Charter School Facility Financing Secured By The Statewide Pool Of Charter School Operating Revenue.*

In most states, charter school operating revenues flow directly to the schools from a state government source. The state agency that controls and disburses these funds therefore is in a position to provide guarantees for facility financing *without increasing the total public cost of charter schools*. To reduce prospective financial backers' primary risk to an attractive level, the state should provide guarantees of up to 50% of a charter school's annual debt service for facility financing amortized over a period of ten years or more. These guarantees should apply whether or not a school's charter is revoked or expires before the end of the financing period.

To qualify for such a guarantee, a charter school should be required to demonstrate that its facility plan meets feasibility, cost, and credit criteria reflecting standards like those elaborated in this paper. All charter schools should be eligible to apply for a partial guarantee of their facility financing, and all should contribute to the fulfillment of any guarantee invoked because of a charter school financing default.*

To implement this financing guarantee program, the state agency that controls and disburses charter school funds (or an appropriate designee) should develop and promulgate program application requirements. Because the program's primary goal is to promote *private* financial backing for charter school facility acquisition, one of its unwaiveable requirements should be that a charter school seeking facility financing have arranged its best deal with one or more prospective backers before requesting the guarantee. In turn, the agency should be

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* One proposed mechanism for doing this involves taking a proportionate share of funds "off the top" of each school's aggregate public funding to cover the liability in any given year. For example, if one school defaults and loses its charter, those remaining would have a proportionate share of the resulting annual obligation deducted from their operating revenues before the revenues are disbursed.

prepared to commit to a rapid evaluation of and decision on the request once it is made. The aim is to keep the onus for determining whether a particular charter school facility project is worthy of financing on prospective backers, while reducing their potential financial exposure enough so that they can and would offer affordable financing to charter schools with sound facility development plans.

For Prospective Facility Financing Providers

Acknowledge Charter Schools As A Growth Industry, And Develop A Formal Approach To Meeting Their Capital Needs.

In Massachusetts and across the country, charter schools are no longer "experimental". More than 800 currently operate in almost 30 states. President Clinton has called for the creation of 3,000 charter schools by the year 2000, and the Clinton Administration has committed substantial federal funds to this initiative. In Massachusetts, as many as 50 charter schools will be in operation by September 1998, nearly all of them with long waiting lists. (Approximately 4,000 students are currently on charter school waiting lists statewide.) Even teachers' unions have applied to open their own charter schools in several states.

The burgeoning charter school movement is one of the most salient manifestations of the maturing "baby-boomer" generation's insistence on high-quality services in all areas of their lives *combined with* this generation's disenchantment with government services in general and public education in particular. As a generation, these baby boomers are used to having numerous provider choices and being served well and *appreciated* as customers. They are having fewer children at a later average age than did preceding generations, and hence are particularly demanding vis-à-vis their children's needs. This baby-boomer cohort includes people of all ethnic and income groups--not just white, middle-class, suburban dwellers--and is the largest single voting constituency.

Charter schools already have produced significant, positive results in Massachusetts and other states. For example, in Massachusetts:

- 1995-1997 standardized test results for charter school students show most performing above their local school district averages, and many performing significantly above district averages.
- 46% of students enrolled in charter schools are from minority groups. (Only 21% of students enrolled in regular public schools are from minority groups.)
- 60% of students enrolled in urban charter schools are from poor families (i.e., those eligible for free or reduced-price lunches).

On average, Massachusetts's charter schools offer student-teacher ratios of 13:1. Charter schools also served as a model for the much praised 1997 Boston Public Schools' Pilot School Initiative.

Of particular note, Massachusetts charter schools today provide alternative school facilities that house more than 6,000 students statewide at no cost to local districts and without having added to the Commonwealth's or municipal governments' debt burdens. To accomplish the same result with new construction, Massachusetts state and local governments would have had to fund as much as an additional $150 million in school projects since 1994.

For commercial lenders and other potential providers of capital, charter schools are an excellent investment opportunity vis-à-vis meeting Community Reinvestment Act (CRA) requirements. Concentrated in urban areas, charter schools not only serve a significant underprivileged population, but they also stimulate local job creation and neighborhood commerce.

To formalize their approach to investing in charter schools, interested lenders and other potential financial backers should develop and adopt a standard underwriting procedure for this new kind of client. In particular, potential financial backers--ideally in collaboration with state government agencies that regulate charter schools--should develop and promulgate

detailed fiscal, market and operating standards to be met by schools that want to qualify for capital financing. At a minimum, such standards should address:

- Preferred school management or contract operator experience and qualifications;
- Preferred school curriculum goals, methods and results in diverse settings;
- Preferred measurable demand levels for a school's services in its targeted communities and neighborhoods; and
- Preferred operating cost parameters--with respect to both programmatic expenditures and facility occupancy costs--that charter schools should follow.

In addition to promulgating informative standards for underwriting charter school financing, prospective backers should consider commissioning their own market studies to appraise the general demand for charter school services in financially underserved local communities. By evaluating and targeting such communities for possible charter school facility investment, private capital providers could join charter schools in a powerful partnership to promote both education reform and local economic revitalization.

About The Authors

John Dolan is a management consultant specializing in state and local government finance and operations. For the past two years, he has helped charter schools in Massachusetts and several other states address difficult start-up financing issues, especially those related to facility acquisition and development. Among his clients are Boston Renaissance Charter School, the Commonwealth's largest, and Benjamin Banneker Charter School in Cambridge. Previously, Mr. Dolan served as Deputy Commissioner of the Massachusetts Department of Social Services (DSS) under the Weld Administration. He holds a B.A. degree from Dartmouth College, and an M.B.A. degree from the Wharton School of Business.

Douglas Murray is a Registered Architect in Massachusetts and Connecticut. During the past 12 years, he has been involved as architect and project manager in the planning, design, and construction of more than 20 educational facilities. Since 1994, Mr. Murray has specialized in the development of charter school facilities. His charter school projects include the design, programming, and construction management of facilities for Boston Renaissance Charter School, Phoenix Advantage Charter School (in Phoenix, Arizona), and Rocky Mount Public Charter School (in Rocky Mount, North Carolina). He holds a Bachelor of Architecture degree from the University of Notre Dame.

Gregory Walsh is a real estate investment and development consultant with more than 15 years' experience acquiring facilities for residential, commercial, industrial, health care, assisted living, child care, and school uses. Previously, Mr. Walsh was Director of Real Estate for Massachusetts General Hospital (MGH)--where he was responsible for all MGH's space procurement and real estate acquisition, disposition, and development--and a Vice President of Cabot, Cabot & Forbes, a national real estate development company. He holds a B.A. degree from Boston College.

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