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Report to Congressional Requesters

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CHARTER SCHOOLS

Limited Access to Facility Financing

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Contents

Abbreviations

IRS	Internal Revenue Service
NCES	National Center for Education Statistics
PCSP	Public Charter Schools Grants Program
QZAB	Qualified Zone Academy Bond
RHS	Rural Housing Service

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Health, Education,
and Human Services Division

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The Honorable William F. Goodling
Chairman, Committee on Education and the Workforce
House of Representatives

The Honorable Heather Wilson
House of Representatives

Since the first charter school legislation was passed in Minnesota in 1991, the charter school movement has grown to include more than 1,600 schools, and 36 states, the District of Columbia, and Puerto Rico currently have charter school legislation. Charter schools are public schools that are exempt from a variety of local and state regulations but that are held accountable for improving pupil outcomes. They were created to address concerns about educational quality, parental choice in schools, and the perceived burdens of school bureaucracies. These schools have enjoyed bipartisan support in the Congress. Specifically, in 1994, the Congress authorized funding for start-up costs through the Public Charter Schools Grants Program (PCSP). In addition, President Clinton has announced the goal of supporting the creation of 3,000 charter schools. Although the number of charter schools continues to increase, some policymakers are concerned that difficulties in obtaining funding to construct, lease, or renovate facilities may hinder the growth of these schools.

You asked us to (1) determine the degree to which charter schools have access to traditional public school facility financing, (2) determine whether alternative sources of facility financing are available to charter schools, and (3) discuss potential options generally available to the federal government if it were to assume a larger role in charter school facility financing. To answer these questions, we reviewed state charter school laws and reports by various federal, state, and private entities that provided information on charter schools nationwide, including *The State of Charter Schools 2000* issued by the Department of Education. We interviewed experts who have a national perspective on these issues. To obtain more detailed information about how charter schools finance their facilities, we also interviewed officials in eight states—Arizona, California, Colorado, Florida, Michigan, Minnesota, North Carolina, and Texas—that account for more than 60 percent of all charter schools. In addition, we interviewed federal officials, private lending companies, and major credit rating agencies about facility financing options for charter schools. We did our work in accordance with generally accepted government auditing standards between January and September 2000.

Results in Brief

Charter schools generally do not have access to the most common source of facility financing for public schools—municipal bonds.[1] Charter schools are frequently not part of a local school district and generally have no authority to raise taxes or issue tax-exempt bonds. Charter schools that are part of a local school district might not share in local or state school construction funds because they must compete with other public schools that have their own construction or renovation needs, and local opposition to charter schools sometimes hinders the sharing of funds. State charter school laws vary, and few of them address facility financing or provide funding for constructing, renovating, purchasing, or leasing buildings for use by charter schools.

Several sources of facility financing exist for charter schools, including the allocation of education funds from the state, loans, and private donations. However, these sources may not be adequate to cover costs or are not widely available to charter schools.

- Per Pupil Allocation. The most frequently used source of facility financing for charter schools is the per pupil funding allocation that a state or school district provides for operating public schools (including charter schools). Charter schools may receive less than the average allocation for the schools in the district, depending on the state charter laws or negotiations with the sponsoring agency. Because charter schools use these funds to cover teachers' salaries, books, and supplies, this payment may not be adequate to fully cover costs associated with obtaining a facility, especially for small charter schools or schools in high-cost areas.
- Loans. Loans are not easily accessible or frequently available to charter schools for facility financing. National studies and experts we interviewed indicate that most charter schools are considered credit risks because they often have poor cash flows, lack a long credit history, have short-term charters that can be terminated by their sponsor, or are administered by management teams with limited business skills.

[1] Municipal bonds are tax-exempt bonds issued by a local government entity such as a school district, city, or county.

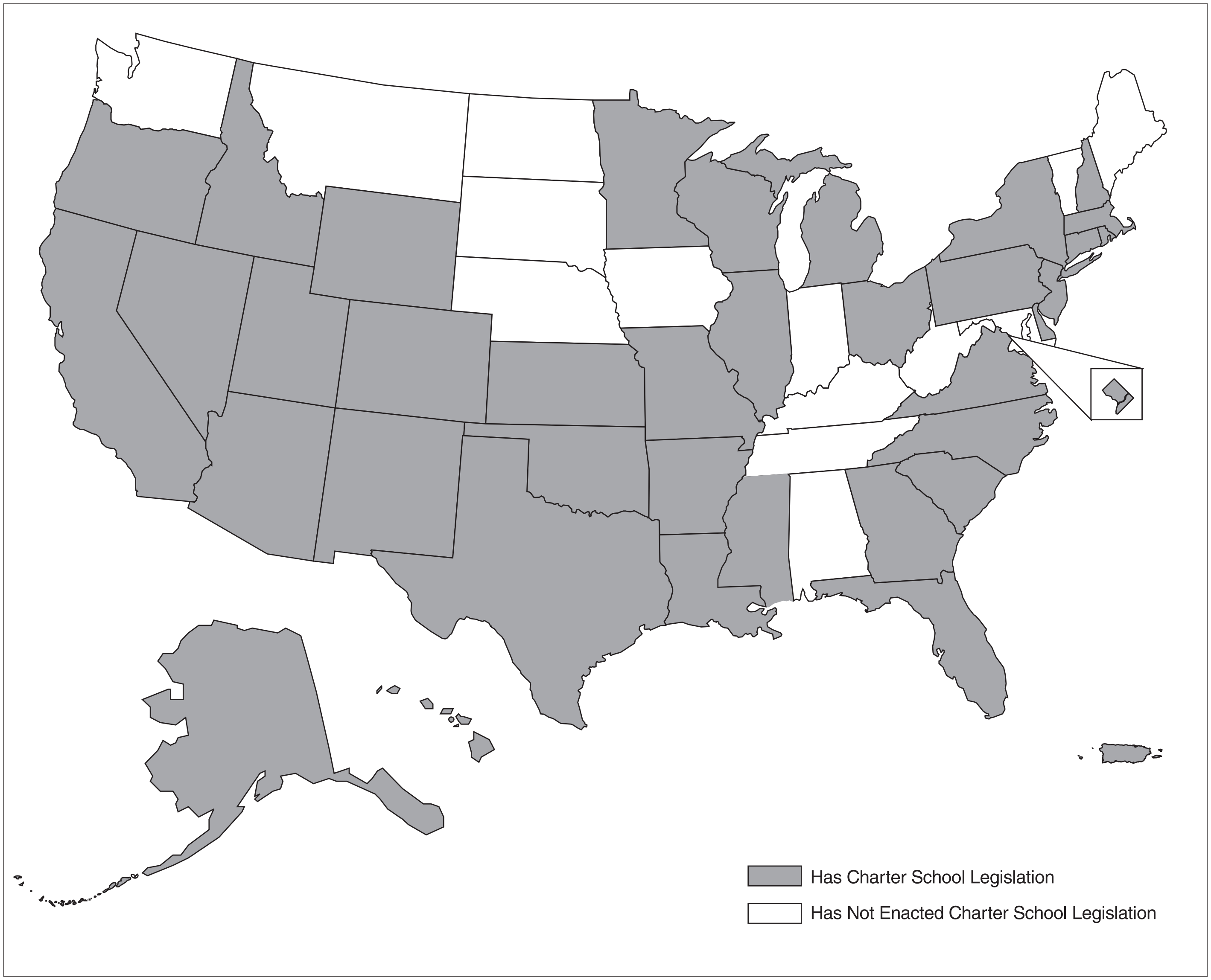
- Donations. Few charter schools have been successful in obtaining a facility from a private donor, and surplus buildings that can be made available by local districts free or at reduced rent either need expensive renovations or simply do not exist.

If the federal government decides to assume a broader role in financing charter school facilities, various mechanisms are available. They include grants, direct loans, loan guarantees, loan pools, tax-exempt bonds, and tax credits, each of which could have different fiscal and programmatic implications for the federal government. Regardless of the funding mechanism used, all will require federal expenditures and most would add to the role that the federal government has indirectly played in public school construction through the tax code. Moreover, increased federal assistance would change the nature of the federal government's relationship with traditional and charter schools as well as with the local and state governments that are primarily responsible for purchasing, constructing, renovating, and leasing school buildings.

Background

Charter schools were created to improve student achievement, enhance parental and student choice of public schools, and help promote educational reform. In the 1998-99 school year, charter schools served about 250,000 students in about 1,600 schools. Thirty-six states, the District of Columbia, and Puerto Rico have charter school legislation, and 31 states, the District of Columbia, and Puerto Rico had operating charter schools as of September 1999. (See fig. 1 for states with charter schools.) The charter school population represented about 0.8 percent of the total number of public school students in the states with charter schools for school year 1998-99.

Figure 1: States With and Without Charter School Legislation



Note: States that have charter school legislation total 36. The District of Columbia and Puerto Rico also have charter school legislation. Fourteen states have not enacted charter school legislation.

Charter schools are public schools that have been formed by teachers, parents, or other community members who enter into a contract (or charter) with one or more sponsoring entities, such as a school district, school board, university, or for-profit company. Although state laws vary, the charter, often in effect for 3 to 5 years, generally

- frees a charter school from many state and local laws and policies to which traditional public schools are subject,
- requires a charter school to meet certain student performance and school management goals, and
- defines the annual budget and sources of income.

The sponsoring entity monitors the performance of the charter school and can renew or revoke the charter, depending on whether the school has met its goals. All charter schools must meet health and safety regulations and adhere to federal antidiscrimination laws.

Charter schools are public schools, and often students from any school district in the state may apply for enrollment, but unlike most other public schools charter schools can limit enrollment according to the space they have available. State law or the school’s charter determines how students will be selected to attend, and all schools receiving federal PCSP funds are required to use a lottery (except converted public schools, which may be required by state law to serve the students who already attend them). The median enrollment for all charter schools is 137, compared with 475 for all traditional public schools. According to Education, charter schools are more likely to include more grade levels in a single school than are traditional public schools. Specifically, almost three times as many charter schools include kindergarten through the 8th grade, and almost four times as many include kindergarten through the 12th grade, as other public schools.

Charter schools can be established in two ways. An existing public or private school is converted to a charter school and remains in the same building, or a new school is started and a building has to be financed. As the number of charter schools has increased, more charter schools begin planning their programs without having a building. According to Education, through the 1994-95 school year, 53 percent of the charter schools that opened were new start-ups that had to find a facility to house their program. By the 1997-98 school year, the percentage of charter schools in search of new space had increased to 82.5 percent. As of September 1999, 7 of 10 charter schools were new start-ups. These newly started charter schools operate in a variety of facilities, including leased mall space; surplus school buildings; space shared with other groups, such as the

YMCA; and converted commercial space. Charter schools also exist as home schools and distance learning facilities.

Education currently offers start-up assistance to charter schools through PCSP, under which grants are available competitively to state education agencies in states that have charter school laws. The states then make subgrants to sponsors in partnership with developers of charter schools. If an eligible state chooses not to participate in the program or if its application for funding is not approved, Education can make grants directly to eligible charter schools. Grantees may use the funds for a variety of activities such as informing the community about the charter school and acquiring necessary equipment, material, and supplies and covering other start-up operational costs that cannot be met from state and local sources. The funds may be used for limited facility costs such as planning and analyzing facility needs, making minor renovations and repairs, and offsetting lease or rent expenses. In fiscal year 2000, the program was funded at $145 million.

Facility Financing for Traditional Public Schools

Public school districts generally obtain financing for facilities from issuing and selling tax-exempt municipal bonds or directly from local tax revenues.[2] School districts cover a defined geographic area, and in most cases, property taxes that residents pay in this geographic area provide the funds for school construction. Local government entities, including some school districts, have the authority to sell municipal bonds, using receipts from property taxes within the district to pay off these bonds over time. The Internal Revenue Code generally exempts buyers of state and local bonds from paying federal income taxes on the interest they earn. In addition to bonds, some school districts have access to revenues from local sales taxes. For example, Florida allows its school districts to levy a ½ percent sales tax, subject to voter approval, for school facilities.

In addition to municipal bonds and taxes, many school districts receive state appropriations for school facilities. In Minnesota, public schools received state funding per pupil that varies by grade level, average building age, and the length of the school year. In Florida, $600 million to $700 million a year in funds for construction and maintenance came from a state

[2] Traditional public schools build or renovate when they need facilities and usually do not lease buildings as charter schools do. Traditional public schools may, however, lease portable classrooms or other structures to supplement primary building space.

tax levied on utilities, with 50 percent going to kindergarten through grade 12 schools. Hawaii (which has a single school district) provides all facility financing for its schools. In the 1998-99 school year, 32 states provided $10.9 billion in aid for school construction.[3] In contrast, 15 states provided little or no support for public school construction, and 3 states could not separate construction funds from their basic support programs.

Concerns about the poor condition and shortage of school buildings nationally have increased federal attention on public school facility financing, although direct federal support for school construction and renovation has historically been limited. We estimated in a series of reports issued between 1995 and 1997 that it would take about $112 billion to bring American school facilities into good overall condition, and Education has estimated that 2,400 new public schools will be needed by 2003 to accommodate rising enrollments.[4] In the 106th Congress, several legislative proposals have been introduced that contain some form of assistance for public school construction. However, no legislation has yet been passed.[5]

Charter Schools Have Little Access to Traditional Facility Financing

Municipal bonds, the traditional source of public school facilities financing, are generally unavailable to charter schools for several reasons.

Many Charter Schools Are Not Part of a School District

Many of the 36 states with charter school legislation and the District of Columbia and Puerto Rico require that charter schools be established as independent legal entities separate from their local school districts. (See

[3] *School Facilities: Construction Expenditures Have Grown Significantly in Recent Years* (GAO/HEHS-00-41, Mar. 3, 2000) and Catherine C. Sielke and others, eds., "*Public School Finance Programs of the United States and Canada 1998-99*," draft.

[4] See our list of related GAO products at the end of the report.

[5] Potentially, a charter school that qualifies as a local education agency (see 20 U.S.C. 8801 (18)) could compete for facility funding under the School Facilities Infrastructure Improvement Act grant program (see 20 U.S.C. 8501 et seq.) administered by Education. However, since the program's enactment in 1994, Education reports that no grants have been awarded to any school because the Congress rescinded all funding for the program in 1995.

app. I for a listing of state provisions.) The remaining states either require that charter schools remain part of the school district or allow them to elect whether they will be independent or part of the school district. Thus, the charter schools that are not part of the school district may not be able to take advantage of facility funding as district schools can. Also, charter school students can come from more than one district.

Charter Schools Generally Do Not Raise Taxes and Issue Bonds

Generally, municipalities such as cities, counties, and school districts have the authority to levy taxes and issue bonds—not individual public schools. Given that many charter schools are independent of a school district, one national study entitled *Paying for the Charter Schoolhouse: A Policy Agenda for Charter Schools Facilities Financing* stated that although charter schools are public schools, it is unclear in some states whether they enjoy the same tax advantages as other public schools.[6] The report also implied that state laws are sometimes not clear as to whether charter schools themselves may issue tax-exempt debt or whether other public bodies (such as city and county governments or special-purpose finance authorities) may issue tax-exempt bonds on behalf of charter schools.[7] However, at least two states have passed legislation for the state bonding authority to sell bonds to finance charter school construction. In Colorado, six schools obtained tax-exempt financing through the sale of nearly $23 million in bonds to fund the acquisition of their facilities. In North Carolina, in contrast, the bonding authority, although authorized to do so, has not issued any bonds on behalf of a charter school because of its reservations about the soundness and creditworthiness of the schools seeking assistance.

[6]Charter Friends National Network, *Paying for the Charter Schoolhouse: A Policy Agenda for Charter Schools Facilities Financing* (Jan. 1999).

[7]Depending on state legislation, charter schools may be set up as nonprofit organizations. Should the schools choose, they may apply for status as tax-exempt organizations under IRS Section 501 (c)(3). If they are granted tax-exempt status, they are generally exempt from paying federal income taxes and are generally eligible to issue tax-exempt bonds. While we know that some charter schools have been granted tax-exempt status, we do not know how many, if any, have received funds from tax-exempt bonds.

School Districts Allowed to Share Local Facility Financing With Charter Schools Often Do Not

Although many school districts can share their facility funds with charter schools, often they choose not to do this. Many local school districts are struggling to meet their own facility needs and are unwilling to share their limited school facility financing with charter schools. In the eight states we reviewed (which are home to approximately 60 percent of the nation's charter schools), only a few districts had made money available. State officials said that little or none of this financing has been made available to charter schools because of local school district opposition to using the funds for these schools.

Charter school authorizing legislation in many of the 36 states, the District of Columbia, and Puerto Rico does not address financing facilities; some allows school districts to provide buildings under various conditions. (See app. II for a listing of state provisions.) The officials we interviewed in the states that do provide money to charter schools for facilities said they establish separate funding streams for this purpose.

Five of the eight states we reviewed—Arizona, California, Colorado, Florida, and Minnesota—provide assistance for facility financing costs to their charter schools. A few other states and the District of Columbia also provide financial assistance. Four of the states we reviewed provide assistance on a per pupil basis, while one provides interest-free loans from a revolving fund, as shown in table 1.

Table 1: States We Reviewed That Provide Facility Financing Assistance for Charter Schools, August 2000

State	Number of charter schools	Type of assistance	Amount of funding per year
Arizona	348	Per pupil payment for facilities	$450 per pupil
California	234	Revolving loan pool[a]	$25 million for renovations with a $250,000 cap per school, 5-year term, interest free
Colorado	69	Per pupil payment for capital expenses and tax-exempt bonds	$234 per pupil
Florida	123	Per pupil payment for facilities	1/15 of a student station, projected in 2000-2001 to be $825, $946, and $1,252 for elementary, middle, and high schools, respectively
Minnesota	53	Per pupil payment for leasing	90% of lease costs up to $1,500 per pupil

[a]Loans may be used for facilities from the time the charter is approved until the end of the first year of school operation. The pool is not used explicitly or exclusively for facilities. It is often used as interim funding until regular state funds are received.

Alternative Financing Is Available for Charter Schools but Obstacles Limit Access

Unlike the five states discussed above, most localities and states do not directly provide funding specifically for facility financing for charter schools, so they must turn to other sources. These include the charter school per pupil allocation from states and local governments, loans, donations from private organizations, and local school district resources. However, these sources are often limited or not easily accessible.

Per Pupil Allocations Are Used for Facility Financing

Charter schools receive annual allocations from a school district, a state, or both to cover instructional and noninstructional costs such as teacher salaries, books, supplies, facility maintenance, and curriculum materials. This allocation is (1) based on a state or school district average per pupil expenditure or negotiations between the charter school and its sponsoring agency and (2) awarded for each student enrolled in a school. According to Education’s National Center for Education Statistics (NCES), the national per pupil expenditure averaged $6,189 in school year 1997-98, and state averages ranged from $3,969 to $9,643.

Although many charter schools use this per pupil allocation to help pay their facility costs (typically rent and renovation expenses), the literature indicates that the allocation often does not fully cover these costs for several reasons. First, charter schools in many states receive less than 100 percent of the allocation that school districts or states give to traditional public schools. Allocations for charter schools range from 75 to 100 percent of what other schools receive. For example, in one county in Colorado, traditional public schools received an annual allocation of $4,555.66 per pupil for operations in school year 1998-99. In contrast, charter schools in that county received 85 percent of the per pupil allocation, or $3,873.21.

Second, because of their small enrollments, charter schools often cannot take advantage of the economies of scale that larger traditional public schools realize. The allocation is based on enrollment, and most charter schools are small. Education reported in 1998 that 34.8 percent of all charter schools and 36.5 percent of new start-ups had enrollments of less than 100 students, while only 8.6 percent of traditional public schools had fewer than 100 students enrolled.

Finally, the per pupil allocation is based on the average cost per student for operating expenses and does not include costs for financing a facility. For example, in the Colorado county discussed above, traditional public schools received $717 per student for facilities from municipal bonds and $223 for facilities and insurance from the state, in addition to their $4,555.66 per pupil allocation, for a total of $5,495.66 from the state in 1998-99. The county's charter schools received no facility payment along with the $3,873.21 per pupil allocation they were awarded. Effective July 1, 2000, Colorado charter schools began receiving an additional $234 per pupil from the state to assist with facility costs.

Thus, the literature and our interviews indicate that the per pupil allocation can be insufficient to cover both the operating and the facility costs charter schools incur. This is an especially difficult problem for charter schools in high-cost areas where leased space is costly or in cases where expensive renovations are needed to transform a building into an acceptable school facility. However, some charter schools can realize cost savings that offset lower per pupil allocations because these schools are exempt from certain regulations. For example, depending on their charter terms, charter schools may not be required to hire unionized staff, provide transportation or hot lunches for students, or adhere to certain public school building codes that traditional public schools must adhere to.

Charter Schools Have Limited Access to Private Loans

Charter schools generally have limited access to loans from private lenders because they are perceived to be poor credit risks. According to the literature and experts we interviewed, lenders view charter schools as credit risks for several reasons.

- Limited cash flow tied to enrollment. Because the annual per pupil allocation is the primary source of funding for most charter schools, enrollment changes can significantly affect the amount of cash available. In addition, charter schools use the per pupil allocation to pay for operating expenses as well as facilities. Thus, without evidence of a steady and growing enrollment, lenders may have concerns about whether a charter school will have a steady source of funding to repay borrowed funds.
- Limited credit history. A charter school that is just opening or that has been in operation for only a year or two generally has an insufficient credit history to qualify for a loan. Without a proven record of acceptable performance as a borrower, many charter schools appear to be risky to potential lenders.
- Inexperienced management teams. In many cases, charter schools are begun and operated by teachers, parents, and others who want an alternative to the existing public school system. While these education entrepreneurs have a vision for the academic programs they want to create, they may not have the financial and managerial experience necessary to convince potential lenders that they can provide the management skills necessary to successfully run a school.
- Short-term charters. Charter schools are subject to periodic evaluations that determine whether their charters—usually in effect for 3 to 5 years—will be renewed. Loans for large-scale building and renovation projects are generally amortized over a 15-to-30-year term. Thus, lenders are wary of charter schools because their charters may expire or be revoked before a loan matures. Most often, the reasons for revoking or not renewing charters are based on a school's failure to achieve certain educational objectives, although financial mismanagement has also resulted in several charter revocations.

The lenders we interviewed have attempted to provide facility financing to charter schools through programs designed to aid underserved communities or persons. These programs often had less stringent loan qualification requirements but usually carried higher interest rates because of perceived risks. Moreover, even with more lenient loan qualification criteria, some charter schools have had to pool their resources in order to acquire private sector funding. One of the two credit rating agencies we interviewed has given an investment grade bond rating to a pool of seven schools that applied together in order to qualify.[8] In addition to the pool, five individual charter schools have been awarded an investment grade bond rating by the two credit rating agencies we interviewed. One agency noted that all the schools that were rated had been in existence for several years and had demonstrated some success. The credit rating agency told us that the ratings would not likely be available to new charter schools without some kind of additional financial support, such as a loan guarantee. Officials representing the lenders and credit rating agencies stated, however, that they see charter schools as a growing market and that they expect that over time, as more charter schools succeed, become more experienced, and develop a reputation as good business investments, more private sector financing will open up to them.

Federal Assistance for Charter Schools Facility Financing Is Limited

Two federal programs—the Department of Agriculture's Rural Housing Service (RHS) and the Qualified Zone Academy Bond (QZAB) program administered by the Department of the Treasury—have provided some assistance to charter schools needing facility financing. RHS makes loans to develop rural community facilities in areas with populations up to 20,000. In order to qualify for these loans, applicants must be unable to obtain funds from community sources at reasonable rates and terms. Interest rates for these direct loans are based on current market yields for municipal bond obligations. Through this program, RHS has loaned $3.32 million to 4 charter schools in two states. One additional application in another state for $5 million is under consideration.

The QZAB program has provided financial assistance to at least one California charter school. However, QZAB assistance is available only for renovations, not for new construction.[9] In addition, a school qualifies for these bonds only if it is located in an empowerment zone or enterprise

[8]Credit rating agencies assess credit risks on bonds and other financial instruments. Such ratings help investors, such as bond buyers, manage their credit risks.

[9]The President's school modernization proposal would expand this program to include new construction.

community or if it has at least 35 percent of its students eligible for free or reduced-price school lunches.

Private Donations Are Limited

While private donors have provided both buildings and funding for facilities to charter schools, the number of such donations appears to be small. Although Education does not maintain data on the numbers of donated buildings, officials told us that access to private donations is limited. In addition, none of the states we reviewed except Colorado could provide information on the number of donated buildings, but most state officials said the numbers were small. A Colorado study identified five donated buildings among 64 schools. One private lender identified three charter schools that had received private monetary donations that were used to secure loans. We were also told that some charter schools join with educational management companies that may provide or lease facilities to charter schools.[10]

Limited Use of Surplus, Low-Rent, or Free Buildings

Some states require that all surplus buildings in local school districts be made available rent-free or at a reduced rate to charter schools, although most state officials we spoke to said this option has not provided many buildings for charter schools. A Colorado study identified 19 of 64 schools operating in rent-free district facilities.[11] Another state official pointed out that with the current boom in school enrollment, it is unlikely that surplus buildings will be available.

A Number of Options Would Be Available If the Federal Government Increased Its Role

If the federal government decides that it wants to support activities to increase charter schools' access to facility funding, it can choose a number of financing mechanisms to do so. The mechanisms include providing direct assistance through grants and loans and encouraging private sources of funds through loan guarantees, loan pools, tax exempt bonds, and tax credits. The federal government currently uses these financing mechanisms to subsidize a wide variety of activities such as the

[10]Education management companies are for-profit organizations that can offer a range of services for schools from a small contract for administrative assistance in starting and running a complete charter school.

[11]Colorado Department of Education, *Charter Schools Capital Finance Study: Challenges and Opportunities for the Future* (Jan. 2000).

construction of low-income housing and the development of enterprise zones. These mechanisms have different characteristics that may affect how charter schools are assisted, and they would have different fiscal effects for the federal government. The following section is not intended to be an exhaustive discussion of federal financing mechanisms or tools; rather, it highlights a few general characteristics about each of them as they relate to charter schools facility financing.

Grants

Grants are payments from the federal government to state and local governments, organizations, or individuals to help them finance activities that fulfill certain federal goals. Grant recipients do not repay funds. Grants are generally available to a broad group of eligible applicants, but some grant programs target funding to applicants on the basis of their demonstrated financial need (for example, the Impact Aid School Construction Program). Grants can include provisions that encourage state and local spending on program activities, although most do not. For example, some grants have matching or maintenance-of-effort requirements that help ensure that states and localities share the financial support for a program with the federal government. Grants also have financial, accounting, and reporting requirements associated with them. The Congress would need to determine whether states, state authorities, or charter schools should be the recipients of federal grant funds.

Depending on the size of a grant, this mechanism could fully or partially fund the facility needs of a charter school with no obligation to repay. In addition, this option might reduce the need for charter schools to use their per pupil allocations for facility financing. However, providing charter schools with grant funds would increase the federal role, and these expenditures would require additional oversight and administrative responsibilities and might discourage community involvement and ingenuity in finding and renovating space. Also, if the grant were designed without a matching or maintenance-of-effort provision, states and localities that provide no facility funding to charter schools now may be further discouraged from providing assistance, while those that provide some funding may decide to reduce their level of support. For the charter schools, such a program would require no repayment of funds and might allow the schools to use federal funds to leverage private sector loans. However, charter schools might not want to address or be capable of addressing the various fiscal reporting and oversight responsibilities that grants would be likely to require.

Direct Loans

A direct loan involves the disbursement of funds by the government under a contract that requires the repayment of the funds with or without interest, at or below market interest rates (for example, the Farm Labor Housing Loan and Grant Program used to construct, repair, or purchase year-round or seasonal housing for farmworkers). Loan programs are often selective—allowing as participants only those who are likely to repay the loans. Like grants, loan programs generally depend on the federal budget and appropriations process, and qualifying for a loan entails meeting financial and programmatic requirements. Also, loan programs incur loan servicing and other costs in addition to routine administrative costs.

A direct loan program could offer the federal government a way to fund facilities for charter schools, but unlike grants, the amount borrowed could be recouped as borrowers repay their loans. However, because charter schools can be closed by the charter-granting entity for not performing according to the terms of the charter and can have limited cash flow, some loan defaults are likely, and their associated costs would be borne by the federal government. For the charter schools, such a loan program might provide access to funds at below-market interest rates. However, charter schools would have to repay loans and cover any facility costs a loan did not finance.

Loan Guarantees

A loan guarantee is an agreement by the government to, in effect, cosign loans on behalf of eligible borrowers. Guarantees are generally used to increase the credit that is available to finance activities by encouraging lenders to offer loans to populations considered risky or to reduce the interest rate and cost of loans (for example, home loan guarantees provided by the Veterans' Administration). Guarantees are perceived as a way of accomplishing certain federal goals quickly by using existing institutions and private sector resources. However, the federal government would incur administrative costs and would have to include in the budget an expense that reflects anticipated defaults.

The amount guaranteed by the government can be for the entire loan or some fraction of it, depending on the risk the government is willing to assume. The government usually pays program administrative costs and any default costs in loan guarantee programs. For charter schools, a federal loan guarantee would mean access to private money at lower interest rates that might have been previously unavailable to them because of creditworthiness issues, discussed earlier in this report. However, charter schools would still have to find a way to repay loans.

Revolving Loan Pool

A revolving loan pool allows investors (such as the federal government, states, and private entities) willing to support an activity to share the costs and risks of investing in it. A revolving loan pool is a fund created by a number of entities to make below-market-rate loans available to eligible borrowers. The pooled resources earn interest, and eligible applicants are allowed to borrow from the fund. The interest is reinvested in the fund along with payments that fund borrowers make (for example, the drinking water revolving fund of the Environmental Protection Agency that is used to construct water treatment facilities). If a borrower defaults on a loan from the pool, the costs associated with the default are paid from the pool, thus reducing the dollars that can be loaned in the future. The federal government could decide to provide reserve funds to cover the costs of loan defaults and other loan pool expenses.

For this option, the federal government would be likely to provide seed money for the pool or money for the reserves or both. The federal government could also require or provide incentives for state or other entities to contribute. The purpose of a loan pool for the federal government would be to provide funding to charter schools at a lower cost than the private market could do. An advantage is that the government could share some risks with the other pool contributors. For the charter school, a revolving loan pool might mean access to money that has previously been unavailable from lenders because of the perceived credit risk that charter schools pose. As with direct and guaranteed loans, charter schools borrowing from a loan pool would still have to find ways to repay their loans.

Tax-Exempt Bonds

The federal government currently supports the acquisition of public school buildings and other public facilities through tax code provisions that allow tax exemptions on the income from municipal bonds as well as other types of bonds. A bond is a debt instrument bearing a stated rate of interest that matures on a certain date, at which time a fixed sum of money (the principal) plus interest is payable to the purchaser of the bond. Although the federal government collects less revenue because of these tax expenditures, tax-exempt bonds would provide access to private funds at lower interest rates than what charter schools would otherwise have to pay on the open market. Investors are willing to accept a lower interest rate on tax-exempt bonds because of their reduced tax burden.

The Internal Revenue Code limits or caps the amount of certain types of tax-exempt bonds that may be issued in a state. Subject to this cap, states and their qualified governmental units may authorize nongovernmental persons to issue these "private activity bonds" to finance activities that include airports, mass commuting facilities, and sewage facilities, as well as residences for veterans. To encourage state and private investment in charter school facility funding, the federal government could decide to create an additional class of private activity bonds to be used specifically for charter school facility funding. States could in turn include charter schools among the other authorities that are allowed to issue tax-exempt private activity bonds within the state. Such modifications could necessitate raising the cap on the amount of private activity bonds that each state may issue or perhaps excluding these new bonds from counting against the state bond cap. Yet, if such actions are taken and charter schools issue these bonds, the creditworthiness of most charter schools and their ability to repay debt will remain a concern for bond raters and buyers, especially for newly created charter schools. Moreover, charter schools would still have to use their revenues to cover the costs of issuing the bonds and their debt service.

Tax Credits

Tax credits, another type of tax expenditure, directly reduce a taxpayer's tax liability. Policymakers use them to provide incentives for socially beneficial projects (for example, to encourage public-private investment in low-income housing construction). If a tax credit is refundable, a taxpayer receives a payment from the government when the credit exceeds the taxes owed.

Offering tax credits to lenders could help the federal government aid charter schools with their facility financing needs by encouraging lenders to make loans to these schools that they might not otherwise make or by encouraging donations or grants by private institutions. If the tax subsidy is too low, it might not provide a strong enough incentive (rate of return) for lenders to begin or increase lending to charter schools—considered risky borrowers by many lenders. Nonprofit charter schools cannot take direct advantage of a tax credit because they have no tax liabilities against which to apply a credit. However, these charter schools could offer the tax credit to corporations or for-profit investors with a tax liability in exchange for cash.

Agency Comments

We provided Education with a draft of this report for its review. In its comments, Education said that the report describes well the problems that many charter schools have encountered in obtaining adequate facilities.

Education also provided technical comments that we included in the report as appropriate. Education's comments are printed in appendix III. IRS reviewed the draft report for technical accuracy and had no comments.

As we agreed with your staff, unless you publicly announce the report's contents earlier, we plan no further distribution of it until 30 days from the date of this letter. We will then send copies to the Honorable Richard W. Riley, Secretary of the Department of Education, and others who are interested. We will also make copies available to others on request. If you or your staff have any questions about this report, please contact me or Karen Whiten on (202) 512-7215. Mary Roy, Gillian Martin, and Mitchell Rachlis made key contributions to this report.

Marnie S. Shaul
Associate Director, Education, Workforce, and
Income Security Issue

A Comparison of State Legislation on Charter School Independence

State	How charter schools operate
Alaska	"As a school in the local school district"
Arizona	Independent; "may contract, sue and be sued"
Arkansas	Legislation is silent
California	May form as nonprofit public benefit corporations
Colorado	Public schools are part of the school district (in practice, many are separate legal entities)
Connecticut	Independent, nonprofit entities operated independently of local or regional school boards, in accordance with charter and provisions of state charter law
Delaware	Independent entities; the board of directors has powers similar to those of a Reorganized School District Board of Education, except the power to tax
District of Columbia	Must be organized as a District of Columbia nonprofit corporation. They exercise exclusive control over instruction, budget, personnel, and administration. They have Independent Local Education Agency status for federal program purposes
Florida	Must organize or be operated by a nonprofit corporation
Georgia	Must be nonprofit; all charter schools that were not previously existing public schools remain subject to the control and management of the local board of the school district
Hawaii	Legislation is not specific
Idaho	Nonprofit corporations
Illinois	Nonprofit organizations
Kansas	Remain within the public school system
Louisiana	All charter schools except those converted from a preexisting public school must be established as nonprofit
Massachusetts	Independent public entities, a body politic, and corporate with all powers necessary or desirable for carrying out their charter programs
Michigan	Corporate entities independent of local school districts but subject to leadership and general supervision of the state board over all public education
Minnesota	Cooperative or nonprofit corporations under state law
Mississippi	Legislation is not specific
Missouri	Nonprofit corporations
Nevada	The board of trustees of a school district in which a charter school is located is generally prohibited from interfering with the operation and management of the charter school
New Hampshire	Nonprofit organizations
New Jersey	Independent public schools managed by their own boards of trustees
New Mexico	Public schools authorized by the local district's school board and accountable to that board
New York	Independent and autonomous public schools
North Carolina	Must be operated by a private nonprofit corporation
Ohio	Nonprofit corporations and public schools independent of any school district
Oklahoma	Legislation is silent
Oregon	Legislation is silent

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State	How charter schools operate
Pennsylvania	Public, nonprofit entities and local education agencies
Puerto Rico	Have fiscal autonomy that allows them to draft, administer, and control the budget and purchase materials, books, and supplies
Rhode Island	Part of the school district if initiated by the school district or school personnel; otherwise, independent entities
South Carolina	Must be organized as a nonprofit corporation
Texas	"Governmental bodies"; immunity language appears to anticipate a degree of independence
Utah	Legislation is not specific
Virginia	Alternative public schools within a district and managed by their own management committees
Wisconsin	May exist as local board-sponsored schools, may be instrumentalities of the local district, or the local board may contract with an outside entity to operate the school (local board decides). Milwaukee charter schools not sponsored by the local board become independent entities, with one possible exception
Wyoming	Legislation is not specific

A Summary of State Legislation on How Charter Schools Obtain Facilities

State	Provisions on acquiring facilities
Alaska	Not specified. Law permits operation in existing district facilities upon approval of district administrative staff
Arizona	Law calls for preparing a list of vacant state-owned facilities and land
Arkansas	Not specified
California	School district where charter school operates must permit free use of district facilities not in use
Colorado	Charter schools must be able to use district facilities "deemed available" at no rent, except for operations and maintenance
Connecticut	Not specified. Commissioner of Education must annually review and report to the General Assembly on the adequacy and availability of suitable facilities for charter schools
Delaware	Charter schools have preference in leasing public buildings; districts are to "make unused buildings or space…in buildings available to a charter school, and shall bargain in good faith over the cost of rent, services and maintenance related to such space." Delaware Department of Education must publish an annual list of facilities available for charter school use
District of Columbia	D.C. government must grant charter schools preference when leasing or selling former public school facilities
Florida	Surplus district facilities must be provided for charter schools and public schools on equal basis
Georgia	Legislation is silent
Hawaii	Not specified
Idaho	Not specified
Illinois	Individual schools determine. Conversions from public or private schools are not to be charged rent for available district facilities
Louisiana	Local school boards must make vacant facilities available at fair market value. If the facilities were constructed at no cost to the local school board, such facilities must be provided to charter schools at no cost
Massachusetts	"May own, lease or rent its space"
Michigan	May acquire property by purchase, rent, lease, gift, or condemnation
Minnesota	Must lease space, preferably from a school board or other nonprofit, nonsectarian organization; if it is unable to find appropriate space this way, it can lease from a private or for-profit organization or, as a last resort, from a state approved sectarian organization
Mississippi	Not specified
Missouri	Can borrow to finance facilities. A maximum of 5% of district school buildings may be converted to charter schools. May not acquire facilities by eminent domain
Nevada	May use any public facility within the school district in which they are located. May use district-owned school buildings only during times that are not regular school hours and on approval of the local school board
New Hampshire	Individual schools determine. They can lease or buy from anyone
New Jersey	May not use public funds to construct a facility
New Mexico	Not required to pay rent for available school district facility space, provided that the facilities can be made available at no cost to the district

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State	Provisions on acquiring facilities
New York	May own, lease, or rent its space. The New York office of general services must publish an annual list of facilities available for charter schools' use
North Carolina	A local board of education may provide a school facility to a charter school free of charge; however, the charter school is responsible for maintaining and insuring the school facility
Ohio	May use a district-owned facility under any contract terms that the school district agrees to
Oklahoma	Legislation is silent
Oregon	May enter into contracts and may lease facilities from the school district or any person or legal authority
Pennsylvania	Can acquire real property by purchase, lease, option to purchase, or gift. May not construct a facility with public funds received from the local school district or state education department
Puerto Rico	Legislation is silent
Rhode Island	Public charter schools not sponsored by a public school district may apply for 30% reimbursement of school housing cost from the state
South Carolina	State department of education and budget and control agency must provide a list of vacant public facilities available for rent, lease, or purchase
Texas	Not specified
Utah	Allowed to consult a list of suitable state or school-district-owned property. The state office of education must publish an annual list of suitable vacant and unused portions of buildings
Virginia	Can locate available school district space and may contract with third parties. A public charter school is not required to pay rent for school district facilities
Wisconsin	Not specified
Wyoming	Not specified

Comments From the Department of Education

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF ELEMENTARY AND SECONDARY EDUCATION
THE ASSISTANT SECRETARY

AUG 3 1 2000

Ms. Marnie S. Shaul
Associate Director, Education, Workforce,
and Income Security
Health, Education, and
Human Services Division
United States General Accounting Office
Washington, DC 20548

Dear Ms. Shaul:

Thank you for providing the Department of Education with the opportunity to comment on the draft report Charter Schools: Limited Access to Facility Financing. The Administration strongly supports charter schools, and has set a goal of providing Federal support for the creation of at least 3,000 charter schools in the Nation by fiscal year 2002. In support of this goal, the President's budget would provide an increase of over 20 percent in funding for the Charter Schools program for fiscal year 2001.

Your report underscores the findings of previous reports that documented charter schools' difficulty finding adequate facilities and securing funding to pay for buildings. Charter schools, like public schools in general, are clearly facing a facilities crisis, which is why the Administration has urged Congress to authorize $24.8 billion in tax-credit bonds for school modernization and $1.3 billion in the fiscal 2001 budget for grants and loans for urgent renovations. Charter schools would be eligible to receive these funds. Your report provides further evidence of the need for these investments.

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States and localities have the primary responsibility for paying for facilities in charter schools, just as they do for supporting all public schools. The report demonstrates the progress several States have made in providing funding for charter school facilities. We believe that these recently-enacted policies show promise. The Department, through our Public Charter Schools Program (PCSP) encourages all States to take similar steps. The PCSP has supported this communication among States through targeted sessions at national conferences and electronic communication among school leaders and State-level charter schools' liaisons.

In sum, the Department believes that the report has done a good job describing the problems that many charter schools have encountered in obtaining adequate facilities.

Additional comments are enclosed. Thank you again for the opportunity to review and comment on the draft report.

Sincerely,

Michael Cohen

Michael Cohen

Enclosure

Related GAO Products

School Facilities: Construction Expenditures Have Grown Significantly in Recent Years (GAO/HEHS-00-41, Mar. 3, 2000).

School Facilities: Reported Condition and Costs to Repair Schools Funded by Bureau of Indian Affairs (GAO/HEHS-98-47, Dec. 31, 1997).

School Facilities: Accessibility for the Disabled Still an Issue (GAO/HEHS-96-73, Dec. 29, 1996).

School Facilities: Profiles of School Conditions by State (GAO/HEHS-96-148, June 24, 1996).

School Facilities: America's Schools Report Differing Conditions (GAO/HEHS-96-103, June 14, 1996).

School Facilities: States' Financial and Technical Support Varies (GAO/HEHS-96-27, Nov. 28, 1995).

School Facilities: America's Schools Not Designed or Equipped for 21st Century (GAO/HEHS-95-95, Apr. 4, 1995).

School Facilities: Condition of America's Schools (GAO/HEHS-95-61, Feb. 1, 1995).

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