Purpose of Study
This report was commissioned by the Low Income Investment Fund (LIIF), a nonprofit community development financial institution (CDFI) headquartered in San Francisco, California. Since 1999, LIIF has provided more than $67 million in capital through 82 loans to support the development and operation of charter school facilities throughout the state of California. In the course of these transactions, LIIF and its partners have become keenly aware of the opportunities and challenges inherent in charter school facility development and financing. Given the continued demand for and growth of charter schools in California, it is critical that the industry capitalize on opportunities to provide California’s youth with the education they deserve. An important piece of this effort is a clear understanding of the variety of charter school facilities and the types of financing mechanisms schools use to access and develop their facilities.
This report documents the current fiscal and physical arrangements of California charter school facilities, as well as the resources used by charter school operators to access facilities. LIIF hopes that the information contained in this report will provide a useful framework for schools, policymakers, lenders and charter school supporters in their efforts to design better programs, policies and products to meet schools’ needs. This report does not debate the merits of charter schools, but simply provides information on the current state of charter school facility development and financing within California.

About Charter Schools

Charter schools are independent public schools that operate under contracts, or “charters,” for a fixed period of time—up to five years in California. They are authorized by entities such as the State Department of Education, county school boards and local school districts; the latter is the most frequent authorizer. Charter schools are permitted to operate free of many of the rules and regulations that govern traditional public schools; this autonomy is intended to promote innovation in local education practices. In exchange for increased flexibility, charter schools are held strictly accountable for performance measures such as academic

Compared with traditional public schools, California charter schools serve:
- a higher percentage of low-income students,
- twice the percentage of African-American students, and
- a higher percentage of students with academic difficulties.

— California Charter Schools Association “CCSA”, 2005
achievement, and their charters may be revoked for material noncompliance. Charter schools must be nonsectarian and admit students on a first-come, first-served basis, or through a lottery system if demand exceeds capacity.

Charter schools face even greater financial challenges than traditional public schools. Unlike traditional public schools, charter schools do not receive a dedicated capital funding stream to cover the costs of their facilities. Though California has instituted some initiatives, such as Proposition 39 \(^1\) (Prop 39) and Propositions 47 and 55 \(^2\) (Props 47/55) to help with facility financing, charter schools, in general, must use operating dollars to fund the costs of leasing, purchasing and renovating their school facilities. Public schools, on the other hand, receive special allocations from state bonds and financing to cover their facility costs.

In Fall 2005, LIIF sent a survey to all 574 registered charter school operators in California. Of that group, 95 operators, almost 17 percent of the state’s charter schools, responded to the survey. In-depth interviews with 10 respondents (representing the diversity of charter schools across the state) provided additional context for survey results.

The survey questions covered three main topics:
1. Development of charter school facilities, including information about the types of facilities occupied and how facilities are selected
2. Costs of various facilities solutions and the impact of those costs on charter schools’ budgets
3. Various forms of financing used by charter schools

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\(^1\) Proposition 39 was passed by California voters in 2003. It requires school districts to provide facilities for charter schools serving 80 or more in-district students, in exchange for a minimal management fee.

\(^2\) Propositions 47 and 55 were bond measures passed by California voters in 2002 and 2004. They provide $25 billion in funding for kindergarten-through-college facilities, with $400 million reserved to provide site-based and financially sound charter schools with construction or renovation funding.
Survey results highlight charter schools’ need for additional technical assistance, more information about available resources, and new and flexible financial products and services to finance school facilities. The figures throughout this report represent statistical information from the charter schools that responded to the survey.

**Facility Development**

In general, charter schools choose facilities that provide adequate space, are readily available and are reasonably priced. Due to increasing enrollment, expiring leases and facilities that do not provide enough space for new programs as schools mature, more than half of survey respondents have moved at least once during the life of their charter. While a few public initiatives, such as Prop 39, support facility development, charter school operators require additional help and access to information to more effectively identify and develop permanent and suitable school facilities.

**Types of Facilities**

Charter schools are housed in a wide range of buildings. The most common facility types are vacant school buildings, religious facilities, portable buildings and office spaces. Approximately 30 percent of study respondents (29 operators) use vacant school buildings, including former trade schools, vocational schools and adult learning centers, for their charter schools. This is the most commonly used facility type.

Only 15 respondents obtained sites through Prop 39 arrangements, suggesting that legislation intended to help charter schools secure facilities falls short of its goal. Yet there are opportunities for school districts and schools to forge mutually beneficial relationships. For example, University Preparation School (University Prep) in Camarillo is currently housed in an existing Pleasant Valley District school building. The district leases the building on favorable terms (i.e., $1/year) to University Prep because the previous school closed and the site was unused.

Religious facilities, used by more than 20 percent of respondents, are the second most common facility type. These facilities, which are overwhelmingly located in urban areas where other space is often unavailable, offer stability for survey schools. For instance, more than 75 percent of schools in the study that lease religious facilities have been at the same location for five or more years.

Because portables require a relatively low capital outlay, some schools see them as an economical long-term solution, while others use them as an interim option while they seek permanent sites.

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3. A charter can be renewed multiple times for five-year periods, assuming the school meets its performance and operational goals.
facility for the duration of their charters, as compared with 34 percent of all survey respondents. Stability helps solidify school culture and programs and alleviates the expenses associated with moving and/or constructing new sites.

The third most commonly used facility type is the portable building; almost 20 percent of respondents use this type of facility. These structures are often more economical and less time-consuming to develop than new buildings constructed from the ground up. Because portables require a relatively low capital outlay, some schools see them as an economical long-term solution, while others use them as an interim option while they seek permanent sites. For example, Leadership Public Schools (Leadership) in Richmond is housed in portables near a district high school. This temporary solution enabled Leadership to open relatively quickly. As the school grows, however, Leadership will look for a larger, more permanent site.

Other commonly used facility types are commercial office space (11 percent of schools surveyed) and facilities of other nonprofit organizations (8 percent of schools surveyed). Schools also share nonprofit office space. For example, Desert Academy of Applied Arts and Sciences in Victorville shares a portion of its facilities with services such as legal aid, healthcare, counseling, tutoring and athletics at night. During the day, the school has full use of the building.

**Time to Find a Facility**

Finding a facility can be a time-consuming process. Lack of real estate development experience among charter school operators is a key factor contributing to the amount of time needed to identify and develop facilities. More than 33 percent of study respondents required a year or more to identify and develop their facilities. In addition to facing a shortage of affordable sites, respondent charter school operators are challenged by their inexperience in facilities development. Frequently, the schools surveyed noted that their lack of real estate development and financing experience hindered their efforts. In response, several schools opted to cultivate relationships with intermediary organizations, such as charter school real estate developers, to benefit from outside expertise and allow school leaders to focus their attention on the school’s educational program.

If mutually beneficial, one of the quickest ways for charter schools to identify and secure facilities

![Figure 5: Time Required to Secure a Site](image-url)
is through Prop 39 arrangements, since awards are made the April following the application deadline in December. Twenty-five percent of schools able to locate a site within one year were Prop 39 recipients. For example, Leadership used Prop 39 arrangements to identify locations for two of its four schools in under a year, which enabled them to move into the buildings during the summer.

According to the results of this survey, respondent high schools and schools located in urban areas require more time to identify and develop facilities. Most of the 10 schools that reported spending more than two years looking for facilities were high schools and schools located in urban areas. High schools require larger sites than facilities for the lower grades, and real estate costs in urban areas are higher than they are in rural areas. In addition, there is often a shortage of urban land appropriate for development.

Despite the amount of time and resources spent to find and develop their original school sites, more than 50 percent of respondents moved to new facilities at some point during their charter.

**Facility Cost**

In line with charter schools nationwide, survey respondents spent an average of 13.5 percent of their annual operating budgets on facilities. Only 16 percent of study respondents were able to maintain annual facility costs at less than 5 percent of their budgets. More than 50 percent of these schools remained in the same facility throughout their charters, indicating that low facility costs can contribute to charter school stability.

**Lease vs. Buy**

In California, charter schools receive less money per student than traditional public schools. A 2003 study by the Fordham Foundation showed an average gap of $2,200 per student per annum between district schools and charter schools. Further complicating their financial challenges, charter schools, unlike traditional public schools, must cover facility costs from operating funds. Without the resources required for the up-front costs of purchasing facilities, nearly all of the schools surveyed chose to lease rather than purchase their facilities.

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**Chart:**

- **Facility Cost:**
  - 1-5%: 15
  - 6-10%: 29
  - 11-15%: 27
  - 16-20%: 11
  - Over 20%: 2
  - N/A: 4
  - Did not respond: 9

**Figure 6:** Average Facility Expense as Percentage of Budget
In fact, fully 95 percent of study respondents lease their facilities, with 70 percent securing below-market lease terms. The advantages of leasing facilities include increased flexibility for the school and greater availability and affordability of leased sites compared with sites available for purchase. However, 85 percent of leasing respondents incurred costs for renovations outside the scope of the lease. Schools that find long-term sites also spend a significant amount of time and resources renovating the facilities to make them useable as classrooms and administrative offices. Renovations may also include ensuring compliance with the Americans with Disabilities Act, installation of sewage systems and utility connections to portables. Furthermore, renovation costs on leased space do not contribute to the schools' equity and are not recovered by the charter schools.

Only five survey schools purchased their sites. The purchasing process is both costly and time-intensive, and includes development and construction costs, time required to plan and secure use, and building permits. Despite these challenges, purchasing facilities helps stabilize and build equity for charter schools.

**Facility Financing**

Charter schools use a combination of debt financing, public funds and philanthropic grants to finance their facilities and operations. Though there are challenges involved in securing these dollars, study respondents repeatedly noted that, for California charter schools, demonstrating positive academic achievement helps offset challenges and attract funding.

**Factors Affecting Funding**

In California, charters are granted for a maximum term of five years, and many charter schools in the state have brief operating histories. As a result, traditional banks tend to discount charter schools’ ability to service long-term debt without collateral, significant equity or third-party credit enhancement as an additional source for loan repayment. For new, small, independent charter schools, finding ways to provide this additional protection can be challenging.

Study respondents report that, in their experience, financial institutions review the following factors to determine credit-worthiness:

- Length of charter
- Student enrollment, including current level and trends over time
- Academic achievement
- Fiscal results
- Programmatic focus
- Years in operation
- Composition and experience of management and the board of directors

Capital providers appear to focus the most on a school’s operating history, enrollment and academic achievement, and financial performance. Positive trends are seen as evidence of a charter school’s stability and predictors of continued success, both operationally and fiscally.

**Debt Financing**

Many charter schools have relatively short operating histories and limited operating margins, factors that, when combined with the potential for charter revocation, often cause traditional financial institutions to perceive charter schools as risky borrowers. As a result, private capital offered to the charter school industry often reflects a high risk premium, pushing the cost of capital above what many schools can afford. In general, debt financing is reliably available only to charter schools that have been in operation for a number of years or to those that have strong parent companies or partners, as well as those that seek alternative sources of financing from public and nonprofit sources to guarantee or credit-enhance private debt.

Thirty percent of respondents incurred debt to operate or finance the facilities they own. The sources of financing include bank-supplied lines of credit and term loans, and loans from nonprofit lenders. Less than 20 percent of all schools surveyed obtained bank lines of credit, which were often used to cover short-term or emergency expenses. These loans enable the charter schools to borrow at their discretion up to a specified loan limit. They often come with short payback periods and high interest rates (up to 16 percent for some of the respondents).
Nearly 10 percent of study respondents acquired bank term loans, which were most frequently used to spread large-scale facility expenditures over long time horizons. On these loans, interest and principal are repaid on fixed dates, usually over several years. For banks to consider providing long-term financing, schools must be able to show a long histories and often at least one charter renewal. Study respondents secure the long-term facility loans with deeds of trust.

A smaller percent of respondents obtained loans from nonprofit lenders. These loans range from short-term, cash flow loans to long-term, multi-million-dollar acquisition and construction loans. Nonprofit lenders accustomed to charter school lending often offer more flexible terms, tailored to fit the needs of charter schools that may not meet traditional banking standards.

Public Financing

In recent years, California has expanded and created new state and local initiatives to help reduce the costs of developing and operating real estate for charter schools. Table 1 summarizes the most commonly used initiatives. Though nearly 60 percent of the charter schools surveyed were successful in securing public funds, the challenges involved in doing so prevent even broader utilization.

Figure 7: Sources of Public Funding

Though nearly 60 percent of the charter schools surveyed were successful in securing public funds, the challenges involved in doing so prevent even broader utilization.

Prop 39 was an early attempt to solve facility challenges for charter schools. Prop 39 arrangements vary throughout the state and are often plagued by adversarial relationships between school districts and charter schools. Respondents report that some districts adhere to only parts of the proposition. In Northern California, Aurora Charter High School brought legal action against Sequoia Union High School District for not fully complying with the tenets of Prop 39; the school was awarded a facility in 2002. In 2005, in response to San Diego Unified School District's offering vacant school buildings to private schools rather than to Fanno Academy and KIPP Adelante, two charter schools, both schools brought suits against the district in an attempt to force compliance with Prop 39; this case is still under review.

Many respondents opt to lease directly from local school districts rather than apply for Prop 39. Leasing directly from the district can help charter schools avoid the challenge of locating facilities in the short period between April, when districts make Prop 39 offers, and September, the start of the school year, should the school fail to make adequate arrangements through Prop 39.

Respondents reported that public funding programs are often oversubscribed and have
<table>
<thead>
<tr>
<th>Initiative</th>
<th>Date Effective</th>
<th>Primary Purpose and Eligibility Requirements</th>
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</thead>
<tbody>
<tr>
<td>Charter School Facilities Incentive Grants Program</td>
<td>2005</td>
<td>Distributes $50 million over five years in per-pupil facilities aid that can be applied toward the cost or toward the purchase, design and construction cost of new facilities. Charter schools must be in operation for one year and be in good standing with authorizer.</td>
</tr>
<tr>
<td>Charter School Facilities Program (Propositions 47 and 55)</td>
<td>2002 and 2004</td>
<td>Provides site-based and financially sound charter schools with construction or renovation funding, with 50% of project costs as a grant from bond proceeds and 50% in matching funds from the charter schools. Local school district retains ownership of the property.</td>
</tr>
<tr>
<td>Proposition 39</td>
<td>2003</td>
<td>Requires school districts to provide charter schools with facilities “reasonably equivalent” to district facilities and at nominal cost to the charter school. Charter schools must serve 80 or more students residing in the district.</td>
</tr>
<tr>
<td>SB740</td>
<td>2002</td>
<td>Provides charter schools with reimbursement for facility rental and lease costs of up to $750 per student or 75% of total annual facilities costs. To be eligible, schools must enroll a student population with 70% eligibility for free and reduced lunch or locate in an area where 70% of the local elementary school students are eligible for free or reduced lunch. Schools must apply annually in a competitive process for this funding, which is often capped at a level insufficient to meet demand.</td>
</tr>
<tr>
<td>Charter School Revolving Loan Program</td>
<td>2001</td>
<td>Provides new charter schools with county district codes and California Board of Education numbering with loans of up to $250,000 for cash flow needs, with up to five years for repayment. To be eligible, charter schools cannot be conversion charter schools or charter schools renewed by their charter authorizing entity.</td>
</tr>
<tr>
<td>Qualified Zone Academy Bond (QZAB)</td>
<td>1997</td>
<td>Provides schools in Empowerment Zones or Enterprise Communities, or rural and urban schools serving students with at least 35% eligible for free or reduced lunch, with favorable debt service terms through a tax credit to the provider of the financing. Schools must develop partnerships with private organizations that make contributions to the school worth at least 10% of the money borrowed using the QZAB in exchange for the tax credit.</td>
</tr>
</tbody>
</table>

Table 1: Public Initiatives to Fund Charter Schools in California
extensive requirements that make acquiring this financing challenging. For example, Prop 47 is a bond measure that provides $13 billion in funding for kindergarten-through-college facilities; only $100 million of this funding was allotted to charter schools. According to the schools that responded to the survey, the bond’s long list of requirements and regulations— including firm limits on allowable expenses—discourages schools from applying. In January 2004, the $100 million was disbursed to six charter schools, two of which responded to this survey. Even if a school is awarded bond funding, lengthy negotiations with the district can slow the process down significantly. For example, one charter management organization has been waiting 18 months to use the funds because of lengthy negotiations with the district.

Another obstacle to the use of public programs reported by survey respondents is the need to secure political support from city officials, often in a climate of competing public interests. The two respondent charter schools that accessed the QZAB, a subsidy for schools serving low income students, were able to do so with the support of city officials, who acted as partners in the process. Charter schools with QZAB allocations benefit from reduced costs for bank financing, as QZAB provides a tax credit to lending financial institutions.

Other issues that discourage survey respondents from accessing public financing include lack of awareness of their financing options and lack of capacity to negotiate and compete for these limited resources.

**Grant Financing**

Nearly 40 percent of survey respondents engaged in organized capital campaigns to acquire or upgrade facilities. A few respondents mentioned having strategic plans for their campaigns and indicated that they would benefit from technical assistance in this area. Nevertheless, respondents planned to raise from $100,000 to $20 million, with 30 percent working to raise between $1 million and $5 million.

**Conclusion**

This report summarizes some of the key issues facing charter school facility development and financing in California. The responses LIIF has highlighted point to the complexity of these issues, which are often a result of local or individual school circumstances that could be addressed through broad industry improvements. For long-term viability, charter schools must continue to draw from a variety of financing options and tools, including public programs, loans from banks and nonprofit organizations, and donations. The need for ongoing, school-specific technical assistance with real estate development and financing cannot be ignored. Continued revision and expansion of public polices better suited to support charter school facility development are also needed.

Lack of access to adequate facilities can undermine the full potential of charter schools to provide educational opportunities for California youth. Greater knowledge of facility financing practices can increase opportunities and reduce obstacles for current and future charter schools in the state and nationwide. LIIF hopes that this information will facilitate a broad-based discussion around best practices and strategies to support the continued growth of charter schools in California. By working together to address the challenges and pursue the opportunities highlighted here, the charter school industry and financial institutions can continue to ensure that California’s children receive an education worthy of their potential.
Survey Participants

The Low Income Investment Fund (LIIF) thanks the leaders of the following charter schools for participating in this survey.

Abraxis Charter School
Academia Avance
Academy for Career Education
ARCH Charter School
Bert Corona Charter School
Biggs Public Charter
Camino Nuevo Charter Academy
Castle Rock Charter School
Center for Advanced Research & Technology
Challenge Charter High School
Chico Country Day School
Children’s Community Charter School
Choices Charter School
Chrysalis Charter School
Chula Vista Learning Community Charter School
College-Ready Academy High School
Constellation Community Middle School
Crossroads Charter Academy
Diamond Mountain Charter High School
Discovery Charter School
Dolores Huerta Learning Academy
Edward B. Cole, Sr. Academy
Eel River Charter School
El Rancho Charter School
El Sol Santa Ana Science & Arts Academy
Emerson Parkside Academy Charter
Forest Charter School
Fresno Preparatory Academy
Gabriella Charter School
Gateway High School
Golden Eagle Charter School
Green Dot Public Schools
Growing Children
Guidance Charter School
Hickman Elementary
High Desert Academy of Applied Arts & Sciences
High Tech High Bayshore
Jacoby Creek Charter School District
James Jordan Middle School
Jola Community School
Kings River-Hardwick Elementary School
KIPP Academy of Opportunity
KIPP Adelante Preparatory Academy
Lake County International Charter School
Language Academy of Sacramento
Leadership Public Schools Richmond
LEAP Academy
Learning For Life School
Lighthouse Community Charter School
Literacy First Charter School
Long Valley Charter School
Los Angeles Leadership Academy
Manzanita Charter School
Mattole Valley Charter School
Mid Valley Alternative Charter
Millsmont Academy
MIT Academy
NEW Academy of Science & Art
New Millennium Institute of Education
North Woods Discovery School
Northern California Polytechnical Academy
Nubia Leadership Academy
Oakland Unity High School
Oasis Charter Public School
Oasis High School
Orange County Educational Arts Academy
Ocean Charter School
Opportunities Unlimited Charter High School (OUCHS)
Opportunities for Learning
Pacific Community Charter School
Pacifica Community Charter School
Palisades Charter High School
Paradise Charter Middle School
Pathways Charter School
Piner-Olivet Charter School
Public Safety Academy
PUENTE Charter School
Redding School of the Arts
Renaissance Arts Academy
Rocklin Academy
Sixth Street Prep School
Synergy Charter Academy

Continued next page
Survey Participants, cont.

Trillium Community Charter School
Twin Rivers Charter School
Union Hill Charter
University Preparation School at CSUCI
Valley Oaks Charter

Visalia Charter Independent Study
W.E.B. DuBois
Wilder’s Preparatory Academy Charter School
Willits Charter School
Yuba River Charter School

LIIF also thanks the leaders of the following charter schools (in addition to two anonymous participants) for their additional time and candor:

ARCH Charter School
Bert Corona Charter School
El Sol Santa Ana Science & Arts Academy
High Desert Academy of Applied Arts & Sciences

Lake County International Charter School
Leadership Public Schools
Pacific Community Charter School
University Preparation School at CSUCI