Introduction to Charter School Finance

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Opportunity Zones
CHARTER SCHOOL PROGRAMS

U.S. Department of Education
Office of Elementary and Secondary Education

Introduction to Charter School Finance

This brief provides an introduction to charter school finance for Opportunity Zone investors new to the charter school field. Specifically, this brief summarizes the primary drivers of charter school income and expenses and offers insights into charter school facility investing and financing sources. For additional information, see the brief on The Business of Charter Schools.

Primary Drivers of Charter School Operating Income and Expenses

The following descriptions provide an overview of the income and expenses of a theoretical charter school. Real-world cases may vary considerably depending on their jurisdiction and other circumstances.

How charter schools get their funding

Like other public schools, charter schools receive per student funding from federal, state, and local sources. State and local funding make up the majority of charter schools' revenues – in excess of 90 percent in most cases. Base funding makes up the majority of state funding and covers general per pupil educational expenses. It is calculated as a function of the state's per pupil funding allocation multiplied by the school's enrollment or average daily attendance.

In addition to base funding, schools may receive categorical funding to offset costs for particular student groups or school functions. These categorical funds include Title I funds in support of low-income students, funds for students with special education requirements, or meal programs through the U.S. Department of Agriculture. Some states provide additional funds to support school facility expenses, for instance in the form of per pupil reimbursement, grants, or dedicated loan facilities. Lastly, many schools also engage in fundraising, which can include private donations and grants.

Risks to achieving projected revenue are twofold: 1) falling short on projected enrollment through insufficient recruitment efforts or student attrition, and 2) reductions in per student funding levels from public sources.

How charter schools spend

By far the biggest expense for charter schools is staffing, which depending on school size can range from 60 to 70 percent of total income. Instructional positions tend to be more scalable and make up approximately 65 to 80 percent of total staffing expenses, while administrative and leadership positions make up the rest. The second-largest expense is typically occupancy, which comprises all costs related to operating and renting or owning a school building and may account for as much as 15 to 20 percent of a charter school's income. Administration or management fees (5 to 10 percent) and charter authorizer fees (1 to 5 percent, if they exist) are the next largest expense categories, followed by meal program expenses and contracted services such as accounting or transportation, books and supplies, and other administrative costs.

During times of financial austerity, many schools tend to adjust staffing expenses, for instance through layoffs, furloughs or salary freezes, or to outsourcing services such as meals or maintenance. Long-term obligations such as real estate debt or lease arrangements are typically not an adjustable expense and are therefore carefully weighed before making a commitment.

Charter School Investing and Capital Funding

Most charter schools rely on private-sector capital to fund facility development.

Assessing investment potential

When evaluating a charter school's investment potential, lenders and investors typically undertake a document review similar to other sectors, including audited financial statements, quarterly financial statements (budget-to-actual comparison), tax returns, current year budget, and cashflow projections. Tied to this analysis is the review of enrollment and academic performance data, which form the basis of the school's finances. Many lenders consider real estate expenses sustainable if they are below 15 percent of income, depending on local market dynamics. Financeable project leverage ranges from 75 up to 90 percent loan-to-value ratio. Lenders also require a debt service (or lease) coverage ratio of at least 1.10 to 1.20x. Other covenants that lenders require measure liquidity (a common requirement is 30 or more days of cash on hand) and leverage.

Types of capital funding available

The following table gives an overview of financing options most commonly used by charter schools. With $3 billion in average annual originations between 2015 and 2018, the tax-exempt bond market is the largest source of debt capital. Community Development Financial Institutions (CDFIs) have long been lenders to charter schools and view them as mission aligned, particularly when serving lower income communities. In addition to term loans, which are described below, CDFIs have provided approximately $500 million in permanent debt to fund charter school facilities using the Bond Guaranty Program. Commercial banks are increasingly active in the market, although no publicly available data exist on the total lending volume. Table 1 on the next page details the attributes, costs, and benefits of each of these sources and how they relate to each other.

Additional funding sources

In addition to the funding sources listed above, charter schools can access New Markets Tax Credits (NMTCs) if they are located in qualifying, lower income census tracts. NMTCs are important, albeit highly competitive funds that provide quasi-subsidy between 15 and 20 percent of the total amount of NMTCs in underserved communities. Between 2002 and 2019, NMTCs provided $3.2 billion in allocation to charter school projects. Moreover, the U.S. Department of Education awarded approximately $323 million through its Credit Enhancement Program to eligible organizations who can use the funds to credit enhance charter school transactions, including lease and loan guarantees.

Table 1. Attributes, Costs, and Benefits of Typical Charter School Facility Funding Sources

	Tax Exempt Bond Financing	Commercial Bank Loans	CDFI Term Loans
Attribute			
Loan Amount	Greater than $10 million	$5 to $20 million	Up to $10 million
Maximum Term	35 years	15 to 20 years	7 years
Maximum Amortization	35 years	30 years	25 years
Benefits to Charters	Higher	Lower	Lower
Interest Rate	Lower	Lower	Higher
School Development Stage	Growth, maturity, and expansion	Growth, maturity, and expansion	New start, growth, maturity, expansion
Demographics Student Population	No restriction	No restriction	Lower income census tracts
Closing Timeframe	Longer	Shorter	Shorter
Costs and Benefits			
Underwriting	Conservative	Conservative	More flexible
Transaction Costs	High	Medium	Low to medium
Interest Rate Risk[1]	Low	Medium	High
Loan to Value	~100%	~70%	~90%
Other		May be unfamiliar with charter school	Mission alignment

[1] "Interest rate risk" here refers to the interest rate uncertainty that schools will face if debt needs to be refinanced. For instance, a 5-year loan amortizing over 25 years will have a balloon payment at maturity (the end of year 5), which will need to be refinanced at an unknown future interest rate. The possibility that the interest rates move up is the interest rate risk.

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