Module 1

The Nuts and Bolts of Charter School Finance

Toolkit

Opportunity Zones
CHARTER SCHOOL PROGRAMS

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

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Glossary of Charter School and Charter School Finance Terms

Acquisition Loan

An acquisition loan funds the purchase of land or a building.

Authorizer

An authorizer is an entity or body (e.g., a public school district or university) approved by the state legislature to bring charter schools into existence. Authorizers set up application processes, approve or deny charter school applications, and conduct periodic reviews to ensure compliance with performance measures. At the end of a charter term, authorizers use this information to make a renewal decision.

Balloon Payment

A balloon payment is the principal balance due at the end of the loan term, typically larger than prior payments.

Bridge Loan

A bridge loan is short-term, temporary financing to be repaid by a (committed) future source.

Charter or Charter Contract

A charter contract, sometimes simply referred to as a charter, is the legal document that codifies a charter school's agreement with its authorizer including, but not limited to, required performance measures and/or standards, reporting requirements, and review cycles.

Collateral

Collateral is the security the lender requires for making the loan, typically the property being mortgaged if financing real estate.

Community Development Financial Institution

Community development financial institutions (CDFIs) are lenders and investors such as community development banks, credit unions, or loan or venture capital funds. They have as their primary mission the provision of credit and financial services to underserved markets and economically disadvantaged populations. CDFIs are certified as such by the U.S. Department of the Treasury's Community Development Financial Institutions Fund.

Construction Loan

A construction loan is typically interest only and funds ongoing construction.

Credit Enhancement

Credit enhancement is when an entity provides funds or a guarantee to improve the credit profile of a borrower to allow them to access capital at a more reasonable cost.

Debt Service Coverage Ratio

Debt service coverage ratio is a measurement of the cash flow available to pay current debt obligations. It is calculated as net operating income divided by debt payments due within 1 year.

Free and Reduced-Price Meals

Mission-oriented lenders often observe the percentage of free and reduced-price meal (FARM or FRL) eligible students served by a charter school as compared to the surrounding district to ensure that the charter school is serving a representative population. FRL eligibility is a relevant metric used by the U.S. Department of Agriculture in the determination of school lunch program funds and by the federal government in the allocation of Title I funds.

Guarantor

The guarantor is the party promising to repay the loan should the borrower default on the loan repayment obligation.

Interest Reserve

The interest reserve is the lender-established budget line item to cover interest-only payments during the construction and funding phase of the project.

Leasehold Loan

A leasehold loan funds improvement(s) to leased real estate.

Loan Amortization

Loan amortization is scheduled, periodic (typically increasing) payments of principal such that the loan is fully repaid at the end of the amortization period.

Loan Covenant

Loan covenants are conditions of a loan or bond issue, such as restrictions on how the funds may be used or requirements that must be met.

Loan to Value Ratio

A loan-to-value (LTV) ratio is calculated by dividing the loan amount by the value of an asset (e.g., the appraised value of a property) and is expressed as a percentage. Loans with high LTV ratios may be considered to have greater risk and require higher interest rates. For example, a $15 million loan on a project valued at $20 million would have a 75 percent LTV ratio.

Lottery

Students seeking to attend a charter school must enter an enrollment lottery either directly with the school or with the district (if the district has a universal enrollment policy). Students are selected for admission to the charter school through the lottery. Students that are not admitted are randomly assigned to a position on a waitlist and may become eligible for admission if students that were initially admitted decline their spots.

Mini-Permanent Loan

A mini-permanent loan has a long-term amortization schedule with a shorter term, such that a balloon payment will be due at maturity (e.g., 30-year amortization schedule with 5-year term).

Permanent Loan

A permanent loan has long-term debt with payments based on an amortization schedule such that the loan will be fully repaid by maturity.

Predevelopment Loan

Predevelopment loans are fund expenses leading up to construction loan closing.

Special Education

Authorizers may observe the percentage of special education (SPED) students served by a charter school as compared to the surrounding district to ensure that the charter school is serving a representative population. Some charter schools have programs geared specifically toward SPED students, and in these cases may have a higher percentage of SPED students than the surrounding district. Charter schools receive SPED funding from local, state, and federal government sources.

Term

The duration between loan origination and loan maturity.

Lending Case Study: ABC Charter Schools, Inc.

Introduction

This case study describes a possible charter school transaction structure and financing terms representing one way that schools may secure and finance a new facility. The structure is based on a real-world transaction funded by the Facilities Investment Fund.

Background

ABC Charter Schools (ABC) was founded in 2010 as a 501(c)(3) corporation with a mission to expand opportunities for underserved children to receive quality education. ABC operates various primary educational programs including its Charter School Initiative, through which it serves as the management organization for New Kids Charter Schools (New Kids). In addition to providing financial, operational, and programmatic support (collectively, the "CMO services") to New Kids in exchange for a management fee, ABC secures and develops the facilities in which New Kids operates.

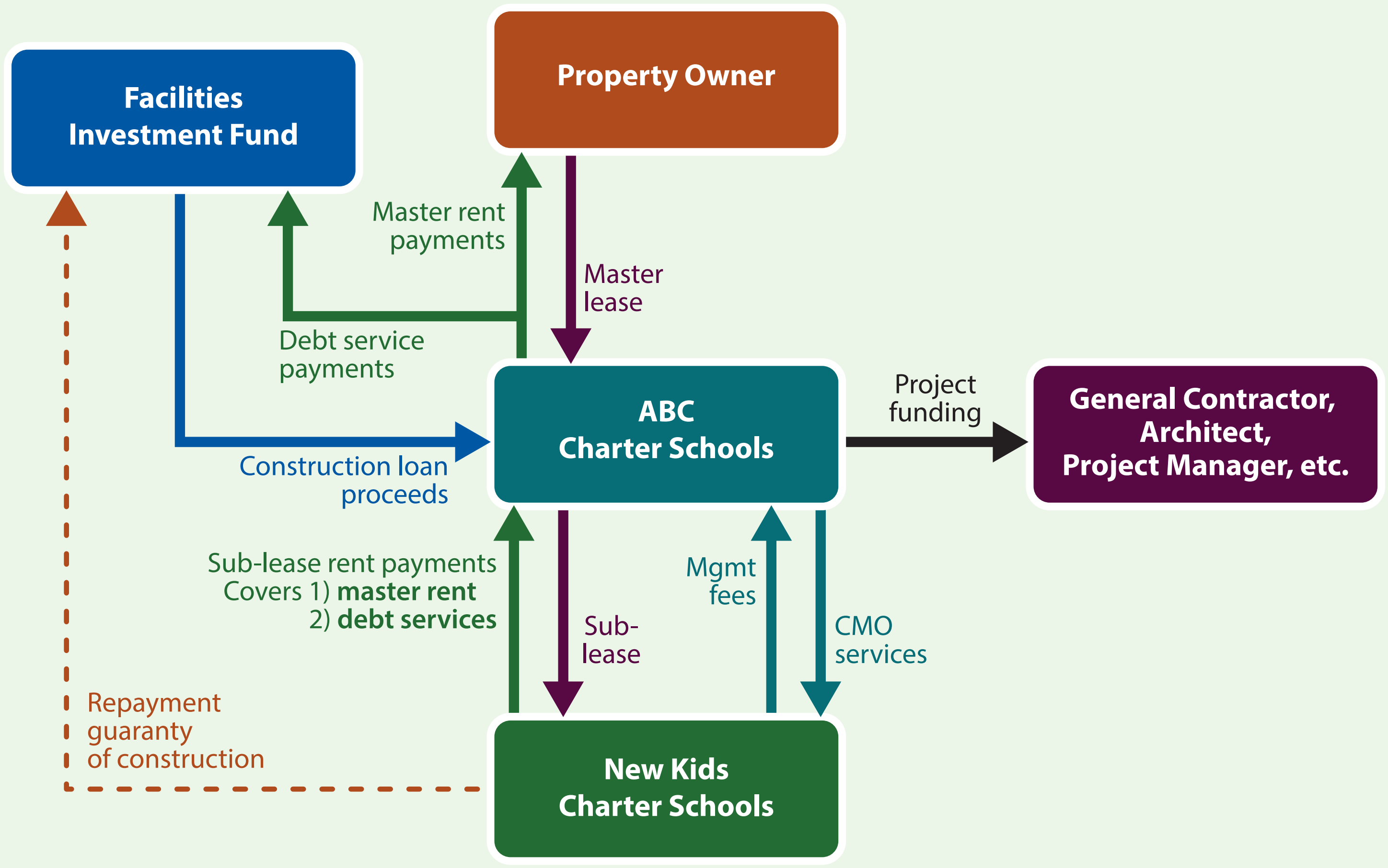
ABC established New Kids as a separate 501(c)(3) corporation in 2015 to operate charter schools in New York City. New Kids provides education focused on character formation to a student population of which over 90 percent receive free or reduced-price lunch. Although ABC conceived, incubated, and founded New Kids, the two entities have separate boards and are not considered affiliates. New Kids is authorized by the State University of New York and currently operates three charter schools. In school year 2019-20, New Kids enrolled 1,000 students and had a 1,500-student waitlist.

Transaction Overview

New Kids entered into a charter contract for a new school requiring a permanent facility. ABC identified a 70,000-square foot educational facility (the Facility), and negotiated a lease agreement with the owner (the Property Owner). ABC leased the Facility from the Property Owner under a 15-year lease that allows for three 10-year extension options. The Facility will serve as the permanent site for New Kids Elementary School. ABC entered an agreement to sublease the Facility to New Kids.

Total renovation costs for the Facility, which was last renovated 50 years ago, were approximately $12.5 million. ABC requested an approximately $11 million construction loan (the Loan) from Civic Builders through its Facilities Investment Fund. As the project sponsor, ABC engaged a general contractor, an architect, and an owner's representative to manage construction. Loan draws were funded to ABC, the proceeds of which payed its project vendors.

Figure 1. Financing Structure for ABC Charter Schools, Inc.



The lease agreement between ABC and New Kids stipulated rent payments in an amount large enough to cover both rent to the property owner as well as debt service on the loan.

Additional Charter School Resources

General charter school information

- Charter school frequently asked questions: https://charterschoolcenter.ed.gov/what-charter-school
- State resources: https://charterschoolcenter.ed.gov/charter-schools-usa
- Comparison of state charter school policies: https://www.ecs.org/charter-school-policies/

Tools to help investors locate potential charter school investment opportunities

- National Alliance for Public Charter Schools: https://www.publiccharters.org/
- National Charter School Resource Center: https://charterschoolcenter.ed.gov/
- Facility financing tool from LISC, a national community development financial institution (CDFI): https://www.lisc.org/charter-schools/
- National lender and local developer Civic Builders: http://www.civicbuilders.org/
- CapNexus by Partners for the Common Good: https://capnexus.org/

Locating state-specific resources

To locate charter school information specific to your state or district, consider doing the following.

- ✓ Visit your state department of education website.
- ✓ Visit your local school district website; some websites may have a section specific to charter schools or school choice.
- ✓ Visit the websites for your state's charter authorizer(s).
- ✓ Visit the website for your state's charter school associations.
- ✓ Contact the state or regional charter school association to find out about financial institutions and best practices.
- ✓ Contact local banks to learn about other funding resources.
- ✓ Use web-based CDFI locators to find CDFIs in your area.

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