

# Houses of Learning

## The Charter Public School Facilities Process

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*by William Donovan*



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Pioneer Institute is an independent, non-partisan, privately funded research organization that seeks to improve the quality of life in Massachusetts through civic discourse and intellectually rigorous, data-driven public policy solutions based on free market principles, individual liberty and responsibility, and the ideal of effective, limited and accountable government.

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# Houses of Learning

William Donovan

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### Contents

Executive Summary	1
Background	2
Best Practices	5
Conclusions	13
Recommendations	15
About the Author	16
Endnotes	16

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## **Executive Summary**

Founders of charter public schools are educators and visionaries. They imagine schools that offer varying learning environments, where novel approaches stimulate creativity and students reach their full educational potential. They share their ideas with others, concepts catch fire and eventually enough people take the leap.

It's at that point that dreams meet reality and charter founders realize creating an actual school is a magnificent goal, but an arduous process. Particularly challenging is finding or constructing a physical place to teach the students. As educators they aren't real estate developers or architects or contractors. Nor are they lawyers or bank loan officers. Yet the skills and experience of all those professionals are required to create a school facility.

Historically in the United States charter public schools have not received building assistance funds from their state governments or district authorities. Nor have they had the ability to levy taxes. Rather, they've dipped into tuition money meant for general operations, combined it with private donations and loan or grant programs, and over time raised enough capital to purchase or build a suitable school.

Charter schools began operating in Massachusetts in 1995 and for their first 12 years they did not receive any specific funding for facilities. Under state statute, charter schools cannot apply for school building funds from the Massachusetts School Building Authority, which is where municipal school systems apply. In 2005 a rate formula was implemented that provided a per pupil capital needs allowance, based on the statewide per pupil average expenditure from state and local sources for capital costs. This funding was provided as part of a compromise to offset a cut in charter funding that occurred when the Legislature changed the charter funding formula to address the concerns of local districts.

In January of 2010, Massachusetts approved a package of education reform measures which included raising the cap on spending on charter schools in low-performing districts from 9 percent of a district's total school spending to 18 percent. In February of 2011, the state Board of Elementary and Secondary Education approved 16 new charter schools in urban areas. Families stranded on charter school waiting lists welcomed the news. But administrators of those schools face the same challenge as their predecessors: finding a place to house their new students.

This paper is intended to act as a guide for charter school founders and directors to accomplish what has been called the "devilishly difficult" task of financing a charter school, finding a location, assembling a development team and building the facility, among other requirements. It draws on interviews with charter school administrators, trustees and policy leaders in Massachusetts and other states, as well as data generated by previous studies on the topic.

The gains that have been made across the country in facilities financing have been uneven among the states. In Massachusetts the additional facilities funding that charters receive from the state has made it easier for them to afford the debt service on loans to pay for renovations or new construction. Grant programs and loan guarantees have helped startups and established schools to accumulate down payments. Together it has meant more schools for families seeking a choice in public school education, more innovations in the classroom by creative teachers and more students receiving the education they need to succeed in life.

## **Background**

Since the charter public school movement began in the early 1990s, charters have operated at a disadvantage not faced by their district school counterparts. Public dollars have generally been unavailable to charters to buy or build a school facility. District schools could tap into state building funds, but charters were left to find their own financing.

Much of the situation can be blamed on politics. The charter movement has been controversial from the start. Supporters argued that they provided an alternative to underperforming traditional public schools. Districts held that charters would merely take the best students and drain money from their schools. To win passage in state legislatures, charter backers often agreed to tradeoffs that enabled the movement's birth but stunted its growth.

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Of the 40 jurisdictions in the United States permitting charter schools today, 11 provide additional per pupil funding specifically for facilities.<sup>1</sup> Some of those jurisdictions are models for others. In the District of Columbia charters historically have received a facilities allowance equal to an average of the District's per pupil facilities expenditures. In fiscal year 2010 that payment was \$2,800 per student.<sup>2</sup> In New York City, 64 percent of charter schools share space in existing Department of Education facilities.<sup>3</sup>

But facilities development remains “the elephant in the room when you talk about finance equity between charters and other public schools.”<sup>4</sup> District schools open in publicly financed new

or restored buildings. Charters use money they receive from the state for operations to pay for bricks and mortar. They hold fundraisers, turn to private donors, call on non-profit and traditional lenders, and seek the assistance of federal or state guarantee programs to raise capital.

District schools typically open in their permanent homes. Charters begin in leased space, sometimes moving to one or two other locations while arranging their financing to purchase a facility. Districts start with defined classrooms, gymnasiums and adjacent open areas. Charters have leased empty grocery stores, restaurants and churches and converted them into schools. Their gymnasiums are often large rooms such as a former car dealer's showroom, with padded poles in the middle. Their athletic fields are sometimes leased from other schools.

Though public schools, charters are left on their own to organize facilities committees with volunteers who have knowledge in real estate development, zoning laws, construction and finance – or at least enough sophistication to hire an expert who can help manage the project.

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In Massachusetts there are 64 charter schools<sup>5</sup>. They include 57 Commonwealth charters, which are independent of local school systems and seven Horace Mann charters, which have less autonomy and operate under the oversight of school districts. Commonwealth charter schools are funded through the state, based upon a per-pupil calculation done by the Department of Elementary and Secondary Education's School

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Finance Unit. For each child that enrolls in a charter school it receives a tuition amount.

Within that tuition aid, Commonwealth charter schools receive a per pupil “facilities tuition” sum from the state. The amount is based on how much school districts, on average, spend on their facilities. In fiscal year 2009 the per pupil facilities rate was \$893.

That assistance places Massachusetts among the country’s 11 jurisdictions that provide additional per pupil funding for facilities and one of the more progressive states concerning charters. But charter backers would argue that such progress hasn’t come easily.

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In fiscal 2005, its first year, the facilities rate was set at \$748 per pupil. It climbed steadily until fiscal year 2009 when it reached \$893 per pupil and remained at that level for fiscal years 2010 and 2011.

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In 1992, when the Massachusetts Legislature was debating education reform legislation that included charter schools, charter supporters agreed to limit the number of new charters to only 25 because to push for more would have doomed their approval.<sup>6</sup> And at a time when many Massachusetts districts were applying for construction funds for their schools from the state, charter proponents acceded to language in the charter statute that prohibited charters from applying for school building assistance funds.<sup>7</sup>

When the Education Reform Act of 1993 was approved, it did not include any specific pass-through for facilities. That changed in 2004 when the overall tuition rate to charters was redone including a new facilities tuition rate component. In fiscal 2005, its first year, the facilities rate was set at \$748 per pupil. It climbed steadily until fiscal year 2009 when it reached \$893 per pupil and remained at that level for fiscal years 2010 and 2011.<sup>8</sup>

Though the new funding allotment of 2004 established a facilities rate for charters, the law did not require them to spend any or all of that money on facilities.<sup>9</sup> In fiscal year 2008 the state provided \$18.6 million in facilities aid, according to Department of Elementary and Secondary Education records.<sup>10</sup>

### Financing Challenges

Charter schools face unique challenges to securing outside financing because of how they’re viewed as borrowers. Lenders look at risk when considering loans. That includes judging management’s track record along with its ability to repay the debt. The managers of startup charter schools typically have little experience in starting a school. The founders are education activists who put together a board of volunteers with experience in areas such as real estate or finance.

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For example, most charter schools plan to grow their enrollment significantly from their initial level to their ultimate total. Lenders look at the likelihood that enrollment will grow as planned, since school revenues rise with the number of attending students. Urban areas, where schools have long waiting lists, offer a better chance to reach the enrollment target than rural areas.

Coupled with concerns about enrollment projections are questions about the ability of the school board to manage the growth. Should it lease space at first and expand with enrollment or acquire a larger building and fill it over time? What is affordable? Lenders expect charters to achieve an increase in assets each year and not lose money.<sup>11</sup>

The lease or buy dilemma is complicated by the fact that suitable space can be hard to locate, particularly in urban areas. Charter school officials have reported difficulties buying or leasing Boston Public Schools facilities or school properties of the Archdiocese of Boston in areas where they'd like to have a school.<sup>12</sup>

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To enhance their chances of obtaining funding, smart charter founders develop plans with as much specificity about their project as they can determine before approaching a lender. That includes having a site selected; having already hired an architect to draw plans; collected bids to determine the projected cost; and developed budgetary pro formas for the school that extend five years out.<sup>13</sup>

When established schools raise funds for an expansion or relocation, their challenge is to demonstrate that they have run their schools well. Many lenders will look into a school's relationship with government authorizers. If they have been reauthorized, they might review all correspondence between the state and the school. They'll consider what school officials said they planned to do when they applied for their charter and how well they're doing it. They'll also take long looks at standardized test results. What has been the trend in test scores over time and how do those scores compare with district schools?<sup>14</sup>

Still another challenge for charters, particularly startups, is convincing lenders they will be in business long enough to pay back their loans. In most states charter schools face a renewal examination every five years. While pulling a charter is an extreme step to address problems at a school, it has happened. Lenders must decide

over what amount of time to amortize the loan. Charters hope the terms aren't frontloaded and costly.

Yet, "as an investment sector, it's probably one of the safest bets that a bank can make," points out Jose Afonso, a former policy analyst with the Massachusetts Executive Office of Education. According to a study by the Local Initiatives Support Coalition, a New York-based national community development support group, the default rate for charter school financing provided by private non-profit organizations, which tend to provide riskier, early-stage financing to charters, is 1 percent measured as a percentage of originated financing, with realized losses of only 0.3 percent.<sup>15</sup>

To help charter schools meet their facilities needs, a vibrant service sector has emerged providing low-interest loans, financing expertise and development consulting. Nationally, more than two dozen private nonprofit organizations have made available \$1.1 billion in direct financial support to charter schools for their facilities needs, in the form of grants, loans, guarantees, real estate development and technical assistance.<sup>16</sup>

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The recession of 2007-2009 and the tightening of the credit market made obtaining capital from private traditional lenders and underwriters of tax-exempt bonds more difficult. But both of those sources have grown more comfortable working with charters as the movement has expanded and matured since the early 1990s.

Two federal grant programs for charter school facilities are available through the Office of Innovation and Improvement within the

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U.S. Department of Education. The Credit Enhancement for Charter School Facilities Program offers grants to help charter schools improve their credit to enable them to get private sector capital to buy, build, renovate or rent school facilities.<sup>17</sup>

A second program, State Charter School Facilities Incentive Grants, provides federal grants to states as incentives for state governments to create a funding stream or support for charter school facilities. It goes to states that have created a facilities assistance allowance.

The federal government also provides facilities assistance through the Qualified Zone Academy Bond Program, a zero-interest bond program providing funds for public school renovations. Qualified Zone Construction Bonds can be used for new school construction, rehabilitation, repair, and land acquisition. The New Markets Tax Credit Program, an economic development program for low-income communities offers tax credits to investors in designated Community Development Entities, such as private lenders who loan money to a charter school in an urban area.

At the state level, MassDevelopment is the finance and development authority in Massachusetts, acting as a lender and a real estate developer. Through the Massachusetts Charter School Loan Guarantee Fund, MassDevelopment provides guarantees for bank loans or tax-exempt bonds that finance the acquisition, construction, or renovation of owned or leased charter school facilities located in Massachusetts.

### Best Practices

Without question one of the most frequently cited obstacles to starting a charter school is developing its facilities. Anecdotally charter school founders and operators note the demands and frustrations of establishing a physical location for their students before they even begin to take on the challenges of educating children in the U.S. today.

The reason is that facilities development has little to do with education and far more to do with real estate, finance and construction. It requires a different set of skills than those needed to create a curriculum or teach in a classroom. Political savvy, connections within a community and an ear to the ground for opportunities can all help a school leader find the right home for his or her students.

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School officials, business consultants and charter school experts stress three points: create a facilities team comprised of people with relevant backgrounds; draw up a development plan that specifies such particulars as school dimensions and desired location; and access available funding sources.

### Create a facilities development team

Creating a physical presence for a charter school is a business venture. It is a time-consuming endeavor involving business plans, real estate appraisals, design schemes and millions of dollars in financing, among other demands. Corporations operate with a management group and so should charter school developers.

Clearly one critical person for the facilities team is a licensed real estate broker who knows the area where the school is to be located. Brokers provide valuable advice on market conditions, availability of properties, negotiations and real estate laws. Their connections are also critical. A well-connected broker can ferret out opportunities and has the relationships necessary to find opportunities.

The Edward W. Brooke Charter School in Roslindale, Massachusetts met with nine different brokerage firms when it began its search for a building to host 475 students in grades K-8. One of the reasons school officials selected the firm that they did was because it had represented the Archdiocese of Boston in other transactions, according to Scott Knox, the school's chief operating officer.<sup>18</sup> School officials were interested in acquiring a closed catholic school owned by the Archdiocese, among other properties.

The more well-connected individuals a school can have on its facilities committee the better. They bring knowledge of the community in addition to their networks. The five-person building subcommittee at the Mystic Valley Charter School in Malden, Massachusetts includes a certified public accountant with real estate experience, the operations manager of a large company with experience in leasing and purchasing facilities, and a local attorney with considerable real estate experience. All live in Malden. On the day that a former auto dealership went up for sale the board members were called by a local broker. They contacted the seller that day and, because they already knew the property well, reached a purchase agreement within hours of their discussion, according to Francis Brown, the CPA on the board.<sup>19</sup>

A facilities development team also needs an architect who can review spaces and explain what is possible within a space. An architect's counsel is particularly valuable to charter schools in urban areas because of the difficulty in finding suitable locations. Charter school start-ups frequently lease and retrofit a property prior to eventually buying a building. Before both transactions a professional's view on what is functionally possible is important.

Architects need to know the number of students a school will have, the grade levels of those students, the types of programs the school will offer and other relevant information about the

use of the facility. An architect who is a volunteer board member and familiar with the education concept of the school can offer suggestions about possibilities and obstacles during the facilities search. Once a building is selected the board should hire a firm for more specific design ideas. Clear communication between the facilities board and the architect is vital. The architect should have a full understanding of the school's needs before creating any designs. Limiting revisions will save time and money.

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A facilities committee can also be well-served by including a lawyer or someone who understands zoning laws and public procurement regulations. Charter school founders often propose locating schools in buildings that are zoned for use other than education. That requires obtaining permits from the local zoning board. Charter opponents trying to prevent a startup or relocation will often fight the zoning change request, arguing perhaps that a building zoned for industrial or commercial use would add to local tax revenues if occupied by a business.

Even if a charter school plans to occupy an existing building that was formerly a school, it could require zoning approval for variances. There may be rules related to parking that conflict with the needs of the school based upon expected enrollment or staff size. Students in the old school may have arrived by bus, but the charter school parents will drop them off, meaning an increase in local traffic during certain times of the day.

## ■ Houses of Learning

Similarly, there may be variances required if the school plans new construction. A new school building on vacant property in a residential area would require zoning approval to insure that infrastructure requirements such as water and sewer are in place to meet the school's needs.

Not understanding the proper zoning laws or filing procedures can be costly. In July of 2010 the Princeton International Academy Charter School in South Brunswick, New Jersey, a start-up K-2 language immersion school, planned to open the following September. But lawyers from nearby school districts challenged the school on a zoning technicality, prompting the local zoning board to delay the school's request for a certificate of occupancy to use a seminary facility.<sup>20</sup> The dispute forced the school to delay its opening until September of 2011.<sup>21</sup>

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School officials who have gone through the facilities development also recommend designating someone at the school to be the point person on the project. It is important for the rest of the facilities team and future vendors to know who the school representative is that will be working on the project each day.

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Once into a project, charter schools are required to utilize the services of an Owners' Project Manager (OPM) to shepherd the school through the architect selection process, submission and circulation of the public bid documents, and the selection of the filed sub-contractors and the general contractor. As publicly funded entities, charters are bound by all public procurement laws. The OPM is required to guarantee compliance.

A knowledgeable facilities consultant can help founders and school leaders to sharpen their thoughts on what they require in a building. An

architect can map out space based upon input from the school board. A charter facilities consultant can help the board be clear with that input.

A useful consultant will provide guidance on financing a new facility. A charter school will likely have a business manager on staff to oversee its records. But the consultant should also know of lenders to charter schools, private nonprofit lenders and federal credit programs.

They'll also advise on whether to lease a facility at first or buy a building. How long should it reasonably take to locate a building and prepare it for opening? What are the stages of development from start to finish? A facilities consultant should be able to help arrange a schedule, providing direction on coordinating the transition from temporary space to permanent home.

School officials who have gone through the facilities development process also recommend designating someone at the school to be the point person on the project. It is important for the rest of the facilities team and future vendors to know who the school representative is that will be working on the project each day. Typically the point person is someone from operations at the school, such as the chief operating officer or director of operations. They'll have an understanding of the facility and finance. Often the school principal assumes this role by default, which can create problems because it takes him or her away from time that should be devoted to the important needs of the school.<sup>22</sup>

After the Edward W. Brooke Charter School selected its real estate broker, the firm requested a meeting with the school's full board to be assured that decision making protocol was in place. The broker wanted a clear understanding of how decisions would be made by the school to be able to act quickly when opportunities emerged.

### **Create a development plan**

The old saying "failing to plan is planning to fail" is sage advice when developing a charter school

facility. There are simply too many moving parts – from the many professionals, to arranging financing, to estimating schedules – to manage the job as demands occur.

Robert Baldwin, a charter facilities consultant, urges schools to conduct an “abstract feasibility study” in preparation for the search for school space. Such a study would include a review of the school’s physical property needs, its financial capacity and steps to prepare for the search process.<sup>23</sup>

The rule of thumb for charter school space requirements is to estimate 100 square feet per student. So if a school has an enrollment of 100 students in the first year, the space needed would be 10,000 square feet. If enrollment will eventually climb to 500 students, the need would be 50,000 square feet.

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But there’s more to be considered when estimating space needs and searching for a location. If the building is only going to include classrooms and administration space, the challenge of finding a structure is difficult but not impossible. But if plans call for a gymnasium, a cafeteria or outside play area, the search becomes more problematic. At that point in planning the founders need to clarify their needs. As Baldwin asks, does the school need a gymnasium when it first opens or would a large room work in the interim? Will students eat in the cafeteria or in their classrooms? Those decisions should be made before school officials start looking at buildings.

While defining physical needs founders should also determine their financial capacity. Developing operating projections will show how much a school will have available each month for

real estate expenses, whether it is a lease payment or debt service.

The 100 square foot minimum requirement for a charter school is also the amount a school would have to spend on a building per student. If the market rate for a facility is \$300 per square foot, multiplied by 100 square feet per student, the building would cost the school \$30,000 per student.

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Ultimately every school would like to own its facility and ideally that would occur at the start. But the cost and the debt service for properties on founders’ wish lists are often unaffordable.

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Dwight Berg, a charter facilities consultant, says schools try to keep their debt payment at 10 percent or less of their annual revenues. If the debt payment amounts to more than that, school officials should try to lower the cost through fundraising, searching for a cheaper facility or considering less space per square foot per student.<sup>24</sup> Charter schools often exceed that 10 percent ceiling and need to fundraise.

With a better understanding of their physical needs, knowledge of local real estate rent and acquisition costs; and estimates of how it would impact their ability to afford their debt; charter founders then face a choice: lease space to start or buy a building.

Ultimately every school would like to own its facility and ideally that would occur at the start. But the cost and the debt service for properties on founders’ wish lists are often unaffordable. Leasing allows young schools to manage costs while growing enrollment and establishing an academic and financial track record. A school that expects to eventually have 600 students may have a growth plan that starts at 100 and increases by 100 per year. If the founders purchased a building

## ■ Houses of Learning

that could fit 600 students, but first year revenues from state tuition reimbursement was only for 100 students, the school would still need to finance its debt as if it had revenue from 600 students.

For that reason leasing at the start is often recommended. Schools move into a suitable space at a cost that enables them to start saving for a future acquisition. While leasing they can continue to search for a permanent location.

In February of 2011 the MATCH Charter Public School in Boston was approved for a new charter to create the MATCH Community Day Charter Public School. The charter plan calls for eventual enrollment of 700 students. But school officials decided to look for temporary space for only 100 students in the school's first year.

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If a school is lucky it will find and lease space that is ready for occupancy. More likely the building will need some renovations or modifications to meet its needs. Buildings once used as schools are ideal because they require fewer modifications.

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"It makes sense from a practical standpoint because our facility needs in the short term are much different from what they will ultimately be," says Tobey Jackson, director of special projects at MATCH.<sup>25</sup>

If a school is lucky it will find and lease space that is ready for occupancy. More likely the building will need some renovations or modifications to meet its needs. Buildings once used as schools are ideal because they require fewer modifications. In 2011 the Edward W. Brooke Charter School, as part of a plan to create a three-school network, leased a former school building in South Boston that was used by Boston Collegiate Charter School before it.

Startups often lease space and then customize it to their needs. But leasehold improvements can be a pitfall for new schools. Founders have a natural desire to put their best foot forward when the school first opens to students and that includes offering optimum conditions. One reason for leasing is to preserve capital for a future acquisition. Without hard-nosed decisions about program needs – a gym vs. a large room – improvements and upgrades can reach into the hundreds of thousands of dollars and potentially be lost to the school should it later move.

The Mystic Valley Charter School in Malden takes the long view on all of its lease agreements and real estate investments. One of its buildings lacks air conditioning. But the school's board chose not to spend the \$500,000 it would cost to air condition 10 rooms. The directors believe the long-term viability of the building is questionable without major renovations. "We are careful we don't send good money after bad," says Francis Brown, a trustee.<sup>26</sup>

In some cities another lease option would be to rent space in a charter school incubator. The District of Columbia's Office of the State Superintendent of Education is developing space with Building Hope, a D.C.-based intermediary organization that renovates and leases facilities at below-market rates to start up charter schools. New charters lease space for up to three years, while sharing "back-of-house" functions and saving money through economies of scale.<sup>27</sup>

Aside from whether or not a temporary location is suitable for the school's needs, the critical component to renting is the lease. Experienced founders and facilities consultants urge designing a lease that is as flexible as possible, given the uncertainty of how long they'll stay. "Swing space" is meant to be a weigh station while school officials seek a permanent location. The development plan may call for moving into a larger facility in year four, but if the ideal spot is available a year earlier they need to react.

“When you’re in the market you want to be ready to act,” says Baldwin. “When the market is hot, which it has been in the past, you’re competing with loft housing developers. You can’t wander in like a poor nonprofit and call a board meeting in a month. You need to be ready and have your powder dry to move on these things.”<sup>28</sup>

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If possible negotiate a short-term lease, that is renewable but also terminable, even at a penalty. The idea is to avoid doubling up on lease-mortgage payments if an opportunity to buy occurs. Berg says startups should remember when negotiating terms that the interim space might remain fallow if they choose not to occupy. That is leverage for the charter school. A startup school of 100 students may only need four rooms and administration space, possibly available in a struggling private school or in a downstairs church hall.

Before negotiating the length of a lease and its exit terms, charter school representatives should estimate how much time they will need before they can move into a permanent facility. Experienced founders have one bit of advice: you will probably need more time than you expect.

The MATCH Charter Public Middle School opened in temporary space in Jamaica Plain in 2008 and school officials were still seeking a permanent home in March of 2011. They came close to purchasing and converting a church in Boston’s South End. They were able to clear several hurdles regarding zoning, permitting and community acceptance. But the deal fell apart because of the anticipated construction costs.<sup>29</sup>

MATCH’s Jackson, who is leading the search, also led Boston Collegiate Charter School’s pursuit of a new building after the school opened in temporary space in 1998. It wasn’t until 2003 that the school purchased property for a middle and high school. “It’s common to take a long time,” he says.

On top of the time it takes to find a suitable location, founders should include in their plans about six to 12 months to complete design work, obtain required permits and secure financing. Then assume another 12 months of construction, depending on the size of the project.

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Extended searches can complicate another rule of thumb in facilities development: move from the temporary space to the permanent location when enrollment has reached 60 percent to 70 percent of capacity. Facilities counselors say that by then finances should be sufficient to overpay for a year or two – meaning able to afford a 600-student building when state tuition revenues are only to cover around 400 students. If the temporary location becomes too cramped and no permanent facility has been found, a move to a larger temporary space may be necessary.

KIPP Academy in Lynn, Mass., opened with 77 fifth grade students in 2004 on the grounds of Holy Family Church. Quickly school officials realized that the space it had, including a building the church had outfitted for a school and space under the sanctuary, would not be enough to handle its growth. By 2008 the school added sixth, seventh and eighth grades and enrollment reached 304. Unable to find alternative space, KIPP attached modular classrooms outside its existing building.

## ■ Houses of Learning

Costs included rental fees for the units and plumbing installations so each mod would have a bathroom.<sup>30</sup> In March of 2011 KIPP was near closing on its final loans to finance construction of a new middle school and high school building, expected to open in August of 2012.

### Access Available Funding Sources

During the past two decades a facilities financing service sector has emerged as the charter movement has matured. A combination of federal and state grant and loan programs, along with private non-profit lenders and foundations, has made it easier for charter schools to find funding to build or upgrade their facilities. More than two dozen private nonprofit organizations in the United States now provide financing for charter school facilities work, combining to offer about \$1.1 billion in direct financial support.<sup>31</sup>

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The federal government's "Race to the Top" education reform grant program, started in 2009, has prompted states to ease their restrictions on the growth of charter schools as they compete for a share of \$4.35 billion in grant money. The Massachusetts Legislature in 2010 raised a cap that had been limiting charter school expansion in low-performing districts. In 2011, 16 new charters were awarded to school founders.

Because charter schools receive state tuition payments based on the size of their enrollment, they are guaranteed revenue to pay for operations when the doors open. But raising up-front money to pay for renovations to rented space or to purchase a school is often a problem. It's then that they turn to the host of lenders that have emerged.

### Startup difficulties

Facilities funding can be more difficult for startup charter schools than for established programs. They lack collateral assets that banks usually require before making a loan. Without borrowing they're unable to afford construction upgrades. So they try to find space that doesn't require costly modifications. If that's unavailable, however, there are other routes for them to take.

The first is to find a friendly landlord willing to pay for the improvements and recover his costs through higher rental fees to the school. As the owner the landlord has a better chance of securing a loan than the school because the building would serve as collateral. But the landlord needs to be cooperative. Will his total fee combining rent and recovering borrowing costs be beyond what the school can afford? Will he add an extra fee to protect against a failure by the start-up school after investing in specific building modifications?

A second course for the school is to enter into a lease agreement, borrow money and pay for the improvements. Yet borrowing the money is difficult. Most traditional lenders are reluctant to lend to start-up businesses of any sort. A construction loan to a start-up school, perhaps with an unproven management team, on leased property is particularly unattractive.

To offset the risk concerns, charter schools can turn to public or private non-profit entities that will either guarantee the loan or make a direct loan for the project. In Massachusetts, MassDevelopment is the state's finance and development authority, acting as a lender and developer with businesses and nonprofits. It works with new and established charter schools by financing facilities and equipment purchases. MassDevelopment can provide guarantees for bank loans or tax exempt bonds to pay for the purchase or construction of a building or for the renovation of owned or leased charter facilities in Massachusetts.

If the facility is owned by the school, MassDevelopment will cover up to 100 percent

of the property value or \$3 million. For leased facilities it will cover up to the lesser of \$1 million or 90 percent of the cost of the improvements.

Rebecca Sullivan, first vice president at MassDevelopment, says the organization works with charter school start-ups to secure loans from private lenders by offering its guarantee and making direct loans to fill gaps. She notes if charter schools borrow from MassDevelopment they are required to follow procurement procedures and take bids on the project before work can begin, because MassDevelopment is a state authority.<sup>32</sup> If a school can find a friendly landlord to pay for the construction, the process is much simpler.

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Charter school officials say that the presence of MassDevelopment in the market has made a significant difference in access to facilities funding. While it is still an ordeal compared to the straight line that district schools have to state building funds, it is much easier. Marc Kenen, executive director of the Massachusetts Charter Public School Association (MCPSA), says a breakthrough for facilities funding in the state occurred in 2003 when MassDevelopment received a \$10 million federal grant with the help of the MCPSA from the Department of Education Charter Schools Facilities Finance Demonstration Grant Program (now called the Credit Enhancement for Charter School Facilities Program).

After Mass Development started guaranteeing loans, Kenen says, other lenders saw that a new market was being invented and became more willing to invest. "That was really when the market broke," he says. "Before Mass Development became this active player, people were having a hard time getting financing from local institutions. No one wanted to take the risk."<sup>33</sup>

The fund has grown to about \$16 million through contributions from Local Initiative Support Corporation, the Boston Foundation and interest income.

When an established charter school is ready to acquire a permanent facility its financing options are more abundant than what is available to start-ups. Because it has a track record of managing school revenues and expenses, plus achieving various academic goals in accordance with its charter, it is seen as a safer investment by lenders. Additionally, most schools have established bank relationships after several years of operations.

In 2009 KIPP Academy needed to arrange facilities financing. At first the project was an expansion of the middle school. Later the school decided to build a new facility to also include a high school. Ilene Vogel, director of real estate, says the school first took its project proposal to a bank in Lynn with which it had done business in the past, seeking to borrow about \$4 million to \$5 million in a conventional mortgage.<sup>34</sup>

Shortly after, KIPP brought the project to several larger private lenders in the Boston area. It also turned to MassDevelopment and other private nonprofit entities. They included the Massachusetts Housing Investment Corporation and Boston Community Capital, both based in Boston, and the Nonprofit Finance Fund, based in New York with a regional office in Boston. Vogel says that while the private lenders were considering the project, the nonprofits were available for "informational meetings" to discuss the programs they offered and to offer suggestions about the quality of KIPP's proposal.

## ■ Houses of Learning

As KIPP's plans changed, the amount of money it needed grew. It ultimately became a \$25 million new construction project, requiring more sophisticated financing. The school decided to use the federal New Markets Tax Credit Program, which provides tax credits against federal income taxes for qualified equity investments in designated Community Development Entities (CDEs).

In KIPP's case the CDE was MassDevelopment. A complicated financing package included a \$7 million tax credit investment from a New York bank and a \$17 million bond debt from a consortium of local Boston lenders. The school put up about \$3.5 million from its own savings and a capital campaign

In addition to state financing authorities such as MassDevelopment, charter schools can obtain financing through community development financial institutions. These are non-profit organizations with socially responsible investment missions such as better schools, community centers, restoration of distressed urban areas and affordable housing projects. Some, such as the Charter Schools Development Corporation, a national nonprofit based in Hanover, Maryland, have a mission specifically devoted to helping charter schools lease or purchase facilities.

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The Nonprofit Finance Fund, another nationwide community development financial institutions, also makes loans to charter schools, but to other worthy nonprofit projects as well. Loans typically range between \$100,000 and \$2 million and are used for acquisition, construction, renovation and leasehold improvements, among others. Based in

New York, it has eight other offices around the country including Boston.<sup>35</sup>

In Massachusetts, Boston Community Capital has invested more than \$550 million to support organizations and businesses that benefit underserved communities since 1985. The Boston Community Loan Fund has made loans totaling more \$300 million to affordable housing developers and nonprofit organizations providing services in low-income communities.<sup>36</sup> Boston Community Capital has made loans to Berkshire Arts & Technology Charter Public School, MATCH School and Boston Collegiate Charter School, among others.

## Conclusions

While acceptance of charter schools varies around the country, establishing a facility to hold classes remains an enormous challenge for founders and leaders in even the most progressive states. Space is scarce in urban areas. Politics and lack of cooperation from local districts can put other buildings out of reach. Some structures might be available, but unworkable as a long-term home. Though district public schools sometimes have their plans rejected by the state, financing new construction or retrofitting existing buildings is a high hurdle they never face alone.

Yet conditions are improving in many states, spurred by the prospect of federal incentives. The "Race to the Top Fund" created by the Obama Administration in 2009 allows states to compete for millions of dollars in grant money for education reform. Federal officials have been blunt about the likelihood that they would look more favorably on proposals that include an emphasis on charter schools.<sup>37</sup> The first two winners, Tennessee and Delaware, received \$500 million and \$100 million respectively.

Massachusetts too has responded to the Race to the Top Fund. In 2009 Governor Patrick pushed to raise the charter school cap in underperforming districts from 9 percent to 18 of that district's net school spending and lauded the enabling

legislation.<sup>38</sup> It was a different posture from 2006 when candidate Deval Patrick opposed lifting the cap on charter schools.<sup>39</sup> When the second round of Race to the Top Fund winners was announced in 2010, Massachusetts was awarded \$250 million for education reform.

Certainly more goes into a winning reform package than just adding charter schools. But the message from the federal government has motivated lawmakers to be more open to charter schools. Tennessee has 32 charter schools with plans to open 11 more in the fall of 2011. Delaware has 19 charters with three more expected to open in August of 2011. Massachusetts awarded 16 new charters in early 2011.

Similarly other federal programs, such as the Credit Enhancement for Charter School Facilities Program and the State Charter School Facilities Incentive Grants Program, have been prods to states to contribute to the public funding of facilities for charter schools, particularly startups. More established schools with track records have benefitted from the Qualified School Construction Bond (QSCB) Program, the Qualified Zone Academy Bond (QZAB) Program and the New Markets Tax Credit Program.

In Massachusetts, MassDevelopment, the state's finance and development authority, has combined a \$10 million grant from the federal Credit Enhancement for Charter School Facilities Program with grants from other groups and guaranteed more than \$16 million in loans and debt for 20 charter schools. That backing has helped startups with leasehold projects, established schools expand their facilities and others building from scratch.

Also of value is the counsel many charter school founders receive from the many finance, real estate and charter school consultants who now specialize in facilities development. Recognizing the disadvantages that charters have to district schools when trying to get started, they have stepped in to fill the needs.

Their guidance generally is as follows:

- Create a facilities team consisting of people with relevant backgrounds in real estate, law, architecture who can work on the search for a site and the development of the school.
- Make sure all of the founders of the school are in agreement about the needs of the facility as they relate to the programs that will be taught.
- Hire an experienced real estate broker who is familiar with the area where the school will be located and connected enough to know about properties as soon as they become available and others that might be in the near future.
- Hire a facilities consultant to act as a guide through the process. Look for someone who has worked with charter schools, knows the available financing options and is experienced in real estate development.
- Create a development plan that includes a review of the school's property needs, its financial capacity and time estimates for site search and modifications.
- Determine if the school needs to lease a facility in its early years or if it can afford new construction or the purchase of a building.
- Develop a financing proposal for potential lenders. Take it to a local bank that has a lending relationship with the school or has relationships with board members.
- Bring the proposal to other traditional lenders and private non-profit lenders. If they pass on doing business, ask for feedback on the proposal.
- Contact state funding arms such as MassDevelopment, who can provide loan guarantees that make it easier for charter schools to obtain financing.
- If leasing at first, continue to look for a permanent facility. Sign flexible leases that permit an early out with a reasonable

## ■ Houses of Learning

penalty, to be able to act on new real estate opportunities when they appear.

- Manage revenues conservatively in the early years to save for a down payment that could be used for a first acquisition, expansion or construction of a larger school.

### Recommendations

#### *Give charters a chance at closed school facilities*

With shifting populations and budget cuts, many cities are consolidating public schools, leaving others vacant. Boston is considering a school closing and merger plan that would leave eight buildings empty after the 2010-2011 school year. In Arkansas open enrollment charter schools have the right of first refusal to purchase or lease at fair market value a closed public school located in a district from which it draws its students. In South Carolina the department of education is required to make available, upon request, a list of school district properties that are vacant and unused and may be suitable for use as a charter school. Louisiana has a law that gives charter schools a first pass at empty public school buildings. By selling or leasing publicly owned buildings to charter schools, cities still receive the income they would otherwise and the area around the school isn't disrupted by a new tenant with a different use, or negatively impacted by a vacant building. Meanwhile charters would lease or acquire a building that would likely require minimal renovations.<sup>40</sup>

#### *Extend the length of charters to 10 or 15 years, with review intervals every five years*

Five-year charter authorizations add to the difficulties charters have in obtaining funding. Already high-risk from a lender's perspective, the prospect that a school might be decertified in such a short time only adds to that perspective. Longer charter periods could also enable longer amortization periods. School administrators should be accountable to state officials for their school's performance. Continuing state reviews every fifth year is sensible. But extending the

length of a charter will provide more comfort for lenders and enhance the chances of start-up charters to obtain funding. Arizona and Washington, D.C. have 15-year charter renewals.

#### *Create a major privately-financed charter school facilities fund*

Federal grant and bond programs have improved the possibilities of charter schools to borrow from private lenders or investors. But the money available for those programs could be threatened by proposals to cut the nation's enormous federal budget deficit. With untouchables such as defense spending, Social Security, Medicare and Medicaid consuming a large portion of the budget, education programs are among the vulnerable outlays. Well-known foundations such as the Bill & Melinda Gates Foundation and the Walton Family Foundation are supporters of charter schools. A pooled fund could play a similar role as the federal government, providing grants for credit enhancement and direct loans to charter schools.

#### *Eliminate the per-pupil funding gap between charter schools and district schools*

Throughout the country, regardless of how progressive state policy is regarding charter schools, there are funding inequities between charter schools and district schools. A national study of charter school funding inequities by Ball State University found that in Massachusetts charter schools were receiving on average \$12,838 per pupil, while traditional public schools would have received \$15,917 for those students. Charter schools were receiving \$3,079 per pupil, or 19.3 percent, less than what the traditional public schools would have received for those students. In Connecticut the difference was 23.3 percent. In New York it was 34.7 percent.

### ***About the Author:***

**William Donovan** is a former staff writer with the *Providence Journal* in Rhode Island where he wrote about business and government. He has taught business journalism in the graduate programs at Boston University and Northeastern University. He received his undergraduate degree from Boston College and his master's degree in journalism from American University in Washington, D.C.

### ***About Pioneer:***

Pioneer Institute is an independent, non-partisan, privately funded research organization that seeks to improve the quality of life in Massachusetts through civic discourse and intellectually rigorous, data-driven public policy solutions based on free market principles, individual liberty and responsibility, and the ideal of effective, limited and accountable government.

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*Dumping the Know-Nothing Amendments: Church, State and School Reform*, Transcript, May 2011

*Be Not Afraid: A History of Catholic Schooling in Massachusetts*, White Paper, March 2011

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## **Appendix 1: Federal Grant and Bond Programs**

### **Credit Enhancement for Charter School Facilities Program**

This program helps charter schools improve their credit in order to obtain private sector capital for facilities. Managed by the U.S. Department of Education, it is available to public entities such as state or local government authorities, private nonprofits, or a consortium of such entities. <http://www2.ed.gov/programs/charterfacilities/applicant.html>

### **The Qualified School Construction Bond (QSCB) Program**

Allows states to grant authorization to qualifying school districts and charter schools to issue QSCB bonds - zero interest tax credit bonds that can be used by any charter school for new construction, renovations, equipment and land acquisition. For information in Massachusetts: 781-338-6500, Massachusetts Department of Education.

### **The Qualified Zone Academy Bond (QZAB) Program**

QZABs are zero-interest bonds that give financial institutions holding bonds a tax credit in lieu of interest. The school district must still pay back the amount of money it initially borrowed, but does not have to pay any interest -- typically about half the cost of renovating a school. Funds raised through QZABs can be used to rehabilitate and repair facilities, excluding new construction and land acquisition. For information in Massachusetts: 781-338-6500, Massachusetts Department of Education.

### **The New Markets Tax Credit Program**

Permits taxpayers to receive a credit against federal income taxes for making investments in designated Community Development Entities, which provide credit and loans to underserved markets such as charter schools in low-income areas. For information in Massachusetts: <http://www.massdevelopment.com/>

### **Recovery Zone Economic Development Bonds (RZEDBs)**

RZEDBs are taxable bonds that finance public infrastructure projects that promote economic development in a designated Recovery Zone. The federal program runs through municipalities. For information in Massachusetts: [www.mass.gov/recovery](http://www.mass.gov/recovery).

### **State Charter School Facilities Incentive Grants Program**

This program provides competitive grants to help states establish and administer “per-pupil facilities aid” for charter schools. The federal funds are used to match programs funded with nonfederal dollars that make payments, on a per-pupil basis, to provide charter schools with facilities financing. The intent is to prod states to share in the costs of facilities funding. The program held competitions in 2004 and 2009 and will post information when dates for the next competition become available. <http://www2.ed.gov/programs/statecharter/index.html>

<b>Appendix 2: Per Pupil Facilities Assistance Rate in Massachusetts</b>	
FY 2006	\$776
FY 2007	\$811
FY 2008	\$849
FY 2009	\$893
FY 2010	\$893

Source: Massachusetts Department of Elementary & Secondary Education

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**Appendix 3: MassDevelopment Closed Charter School Loans/Guarantees  
(as of 3/28/11)**

Product	Borrower	Town/City	Close Date	Amount
Guarantee				
	Berkshire Arts and Technology Charter School	Adams	12/16/04	\$148,000.00
	Holyoke Community Charter School	Holyoke	3/4/05	\$500,000.00
	Marblehead Community Charter Public School	Marblehead	8/12/05	\$300,000.00
	The William Sturgis Friends of Education Foundation	Hyannis	10/17/05	\$295,000.00
	Friends of the Pioneer Valley Performing Arts High School	South Hadley	1/6/06	\$538,000.00
	Foxborough Regional Charter School	Foxborough	1/27/06	\$1,000,000.00
	Phoenix Charter Academy	Chelsea	9/28/06	\$92,500.00
	New Bedford Global Learning Charter School	New Bedford	1/11/08	\$750,000.00
	New Bedford Global Learning Charter School	New Bedford	1/11/08	\$250,000.00
	South Shore Charter Educational Foundation, Inc.	Norwell	5/23/08	\$1,200,000.00
	Abby Kelley Foster Charter Public School	Worcester	6/19/08	\$3,000,000.00
	Innovation Academy Charter School	Tyngsborough	6/30/08	\$1,473,000.00
	Holyoke Community Charter School	Holyoke	7/1/08	\$2,500,000.00
	Lawrence Family Development & Education Fund, Inc.	Lawrence	8/29/08	\$725,000.00
	Friends of the Martin Luther King, Jr. Charter School of Excellence, Inc.	Springfield	6/15/09	\$1,350,000.00
	Foxborough Regional Charter School	Foxborough	6/30/09	\$1,000,000.00
	Hill View Montessori Charter Public School	Haverhill	11/5/09	\$412,500.00
	Lowell Middlesex Academy Charter School	Lowell	3/5/10	\$660,000.00
	Dorchester Collegiate Academy Charter School	Dorchester	8/18/10	\$255,000.00
	Marblehead Community Charter Public School	Marblehead	11/30/10	\$182,804.43
Total - Guarantee				\$16,631,804.43
Loan (with MDFA guaranty listed above)				
	Berkshire Arts and Technology Charter School	Adams	12/16/04	\$148,000.00
	Marblehead Community Charter Public School	Marblehead	8/12/05	\$300,000.00
	Phoenix Charter Academy	Chelsea	9/28/06	\$92,500.00
	Foxborough Regional Charter School	Foxborough	1/27/06	\$3,000,000.00
	Lawrence Family Development & Education Fund, Inc.	Lawrence	8/29/08	\$725,000.00
Total - Loan				\$4,265,500.00

