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## **Funding for Public Charter School Facilities: Federal Policy Under the ESEA**

**Updated February 18, 2005**

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## Summary

A public charter school is a type of public elementary or secondary school that is exempted from certain rules and regulations otherwise applicable to public schools, in exchange for a commitment toward attaining positive results in meeting state content and performance standards in accordance with the terms and conditions of a charter granted by an authorized public chartering agency. Charter schools may enroll students who reside within a particular local school district or a geographic area spanning a number of districts. Chartering agencies may include state, local, and intermediate boards of education, public and private universities, community colleges, municipal governments, or other entities authorized by state law. Depending on how a school is chartered, it may be treated as an independent local educational agency (LEA), as a school within an LEA, or even as a school within a school. All but 10 states have charter school laws.

Just as states differ in how they authorize charter schools, they also differ in how they fund charter schools. States generally require that charter schools be provided funds for operating expenses on a per-pupil basis. However, only in some states is a per-pupil allotment provided specifically for facilities or capital expenses. Many charter school operators report one of their greatest challenges to be obtaining adequate facilities in which to locate their schools. Specific challenges include: limited funding for facilities, limited available and affordable space, difficulty in securing pre-existing public school facilities, and difficulty in obtaining financing for facilities.

This report examines funding for public charter school facilities, including the role of states and the federal government in providing financial assistance for public charter school facilities. Federal support for public charter school facilities is authorized under ESEA Title V — Public Charter Schools, through the Per-Pupil Facilities Aid Programs, and Credit Enhancement Initiatives to Assist Charter School Facility Acquisition, Construction, and Renovation. The Per-Pupil Facilities Aid Programs authorize competitive grants to states to provide federal matching funds on a per-pupil basis for public charter schools facilities. Credit Enhancement Initiatives to Assist Charter School Facility Acquisition, Construction, and Renovation, authorize competitive grants to entities that might be public, private, or a consortium of the two, to enhance the availability of loans or bond financing for the acquisition, construction, or renovation of public charter school facilities.

In FY2005, \$17.0 million was appropriated for Per-Pupil Facilities Aid Programs and \$37.0 million was appropriated for Credit Enhancement Initiatives for Charter School Facilities. For FY2006, the Administration has requested that the programs be funded at \$18.7 million and \$37.0 million, respectively.

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# Funding for Public Charter School Facilities: Federal Policy Under the ESEA

## Background

Public charter schools are publicly funded elementary or secondary schools that are operated according to the terms of charters or contracts granted by public chartering agencies. Charter schools are schools of choice, and thus parents elect to enroll their children in a charter school rather than in the school to which they would otherwise be assigned by their LEA. Charter schools typically receive funding allocated on a per-pupil basis and may or may not receive funds specifically designated for facilities costs. Among the primary factors affecting charter schools' success as educational institutions is their ability to provide quality educational facilities to their students, teachers, and communities. The quality or adequacy of the facilities that a charter school is able to provide depends largely on available funding which, in turn, is impacted by such factors as characteristics of its state's charter school law, the specific terms of its school charter, state and local economic conditions, and the interaction of these and other factors.

The U.S. Department of Education (ED), in *The State of Charter Schools 2000: National Study of Charter Schools — Fourth Year Report*, finds charter school operators reporting that being able to provide adequate facilities ranks high among the challenges they face in implementing their charters and in establishing or continuing their education programs. According to ED's study, three of the top four issues charter school operators cited most often as challenges in implementing their programs involved funding: start-up costs, inadequate operating funds, and inadequate facilities.<sup>1</sup> These funding issues often are interrelated in how they apply to facilities, with the adequacy of charter school facilities often dependent upon the availability of funds for start-up costs and the level of funding provided for operating expenses — both of which frequently are used to pay for facilities.

According to ED's *The State of Charter Schools 2000*, nearly three-quarters of public charter schools begin operations as newly created schools. Operators of these schools must not only implement their new education plans, but also must surmount the obstacle of acquiring adequate facilities in which to house their schools. In

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<sup>1</sup> U.S. Department of Education, Office of Educational Research and Improvement, *The State of Charter Schools 2000: National Study of Charter Schools, Fourth-Year Report*, by Beryl Nelson *et al.*, RPP International, Jan. 2000, pp. 44-45. (Hereafter cited as ED, *The State of Charter Schools 2000*). The report finds that 48.5% of respondents cited start-up costs as a challenge, 37.4% cited inadequate operating funds, 34.5% cited lack of planning time, and 32.0% cited inadequate facilities. In most states, charter school operators must use operating funds to pay for the cost of facilities.

addition, many charter schools are designed to be smaller in size than traditional public schools; and oftentimes, charter schools begin operations with only a few of their planned eventual grade levels, intending to add an additional grade level each successive year. These factors often require charter school operators to arrange initially for temporary facilities as they obtain financing for, and acquire, renovate, or build, long-term facilities. Specific difficulties charter school operators face in obtaining adequate facilities include: limited dedicated funds for facilities; lack of available and affordable space; problems in purchasing, leasing, or occupying pre-existing public school facilities; an inability to issue bonds or assume debt; and obtaining adequate facilities financing.

## **Charter School Facilities in the States**

### **State Funding**

States generally provide charter schools with operational funding on a per-pupil basis — usually a certain percentage of the per-pupil funding provided to other public schools by the state or LEA. Some states and the federal government also provide limited funding for charter school start-up costs. According to the General Accounting Office (GAO), 27 states and the District of Columbia provide charter schools with facilities funding or other forms of assistance in financing or obtaining facilities.<sup>2</sup>

The nature of the support provided varies from state to state. Charter school laws in 12 states authorize funding for facilities, and laws in 19 states allow charter schools access to public facilities. Some states provide per-pupil allotments to charter schools specifically for facilities costs. Some allow charter schools access to funds obtained through local school tax levies or state bonding authority. In some states, charter schools are authorized to assume bonded indebtedness. Other states provide charter schools with access to public buildings or the right of first refusal to purchase surplus public schools buildings that become available for sale.<sup>3</sup>

When public charter schools were first being considered as alternatives to conventional public schools, in some instances, the rationale for their support was the presumption that charter schools would be able to operate more efficiently and at lower cost than conventional public schools. Occasionally, it also was presumed that some of the financial support for public charter schools might be provided through philanthropy. However, while some schools have been successful in obtaining funding or the use of space from private donors or the private sector, many philanthropic organizations have policies prohibiting the use of funds for capital expenses.

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<sup>2</sup> United States General Accounting Office, *Charter Schools: New Charter Schools Across the Country and in the District of Columbia Face Similar Start-Up Challenges*, GAO-03-899, Sept. 2003. (Hereafter cited as GAO, *Charter Schools*.)

<sup>3</sup> For summaries of how state charter school laws provide support for facilities, see GAO, *Charter Schools*; and Education Commission of the States, *Charter School Finance*, Apr. 2003. Available at [<http://www.ecs.org/clearinghouse/24/13/2413.htm>].

## Access to Available and Affordable Space

Obtaining access to adequate and affordable space has been a challenge to many public charter schools. As the nation's school age population continues to grow, there continues to be an increasing demand for education facilities. According to the National Center for Education Statistics (NCES), billions of dollars are needed to fund the construction of new schools and large numbers of existing schools are badly in need of repair.<sup>4</sup> The facility needs of charter schools are not dissimilar to those of conventional public schools, with the level of need often varying according to geopolitical and socioeconomic factors. A majority of charter schools are concentrated in high growth states or in cities with troubled urban school districts. In high growth states, there is an overall shortage of public school facilities. In these locations, both charter schools and conventional public schools are struggling to obtain new or expanded facilities. Often conventional school districts welcome the arrival of charter schools because they relieve some of the pressure for building new facilities. In urban school districts, it is more likely that existing educational facilities are underutilized; however, often they also are in need of repair or renovation. While charter school operators can sometimes acquire excess facilities in which to operate a charter school, often they must bear the cost of renovation.

In general, the limited amount of funds allocated specifically for facilities and capital expenses has resulted in some charter school operators experiencing difficulty in obtaining adequate school space in which to educate their students, resulting, at least initially, in charter schools being housed in non-conventional or less than desirable facilities.<sup>5</sup> Examples of non-conventional charter school facilities include churches, museums, movie theaters, and former commercial or industrial buildings — places where charter school operators have been able to obtain space at affordable rates while they work to secure more adequate facilities. Other charter school facilities include space formerly used by private schools or organizations such as YMCAs and recreation centers.

Depending on characteristics of a state's charter school law and the size of the local school age population, some charter schools are able to obtain facilities from local school districts. Options include converting a pre-existing school to a charter school and retaining use of the building or occupying excess facilities made available by a local school district. Some state charter laws require local school districts to provide charter schools access to excess facilities, either at no expense or for a nominal fee. Other state laws require school districts to offer charter schools the right of first refusal when existing public school facilities are sold or allow charter schools to purchase public school facilities at a discount. In many instances, the

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<sup>4</sup> U.S. Department of Education, Office of Educational Research and Improvement, National Center for Education Statistics, *Condition of America's Public School Facilities: 1999, Statistical Analysis Report 2000-032*, Washington, D.C., June 2000, p. B-29.

<sup>5</sup> While charter schools are relieved of many education rules and regulations in exchange for increased accountability, under the ESEA Title V Public Charter Schools program they are required to adhere to Part B of the Individuals with Disabilities Education Act and "all applicable Federal, State, and local health and safety requirements" (ESEA Title V, Section 5210 (1)(G) & (J)) (20 U.S.C. § 7221i(1)(G) & (J)).

availability of excess public school facilities is strongly correlated with growth or decline in the local school age population. In high growth areas, few, if any, excess school facilities are available and often public school districts are struggling to provide adequate school facilities for their burgeoning student populations. In areas with declining school-age populations, excess school facilities often are available, but may be outmoded or poorly maintained.

## Facilities Financing Options

Whereas conventional public schools generally finance the construction or renovation of facilities through local tax levies or the issuance of municipal bonds, in most cases such options are not available to public charter schools. However, in most states with charter school laws, public charter schools are authorized to assume debt for purposes of financing facilities, although the entity ultimately responsible for the debt varies from state to state. In some states, the charter school is fully responsible for the debt, whereas in others, the local school district or the chartering authority would become responsible should the charter school become unable to retire the debt. In a number of states, bonding authorities have been established to issue securities to finance charter school facilities. Access to state or local bonding authority is important because federal tax exemption of interest earned on state and local bonds<sup>6</sup> supports the ability of bonding authorities to issue bonds at a lower interest rate than purchasers otherwise might accept if their interest earned were taxable.

In instances where charter schools are not able to assume debt under state or local bonding authority, a variety of factors make obtaining financing difficult. Lenders decide whether to provide financing, and if so, set the interest rate at which they provide financing, based on their perception of risk. Financial institutions have tended to regard charter schools as risky ventures because of their novelty and uncertainty about their long-term viability. Charter schools still are a relatively new concept in education and lenders do not have much experience working with them. Also, lenders have been reluctant to issue loans for periods exceeding the length of a school's approved charter.<sup>7</sup> Analysts in public finance have found that over a nine-year period charter schools experienced a closure rate of 4.0% compared with a 20-year school district default rate of 0.05%. This represents an 80-to-1 margin when comparing charter school and public school district risk.<sup>8</sup> Higher interest rates and shorter repayment periods often combine to limit charter schools' opportunities for financing facilities.

Some states make funds available to public charter schools through revolving loan funds. Revolving loan funds may be established by a public or private entity

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<sup>6</sup> Internal Revenue Code, § 103.

<sup>7</sup> Charters in most other states are approved for a period of up to five years, however, they may be granted for up to 15 years in Arizona, the District of Columbia, and Florida.

<sup>8</sup> Jason F. Dickerson, Frederic J. Martucci, and Pamela K. Clayton, *Charter Schools: Growth, Challenges, and Policy Options*, Fitch IBCA, Duff & Phelps, May 31, 2001. Available at [<http://www.fitchratings.com>].

and provide capital to charter schools, usually at a lower interest rate than otherwise might be available. As the loans are repaid, the capital and interest that flow back into the fund become available to make future loans. Revolving loan funds have been used to finance charter school facilities and cover start-up costs. Still, along with all other types of debt, unless a charter school has access to funds specifically allocated for facilities, it must pay off any debt it incurs with a portion of its revenues — usually its operating funds.

## Federal Policy

### Brief History of Federal Assistance for Charter Schools and Charter School Facilities

For several years prior to the ESEA being amended by the No Child Left Behind Act (P.L. 107-110), the federal government had established itself as a provider of financial assistance to public charter schools.<sup>9</sup> In response to concerns about charter school start-up costs and the availability of operating funds, the 103<sup>rd</sup> Congress authorized the Federal Public Charter School (PCS) program in 1994 as Title X, Part C of the Elementary and Secondary Education Act (ESEA). The 105<sup>th</sup> Congress amended and expanded the PCS program under the Charter School Expansion Act of 1998. Under the PCS program, funding has been provided for the design, implementation, and evaluation of public charter schools since FY1995.

Federal funds for charter school facilities first were authorized and appropriated by the 106<sup>th</sup> Congress under the FY2001 Omnibus Appropriations Act (P.L. 106-554). P.L. 106-554 amended the PCS program with the creation of the Charter School Facilities Financing Demonstration Program. This program authorized ED to award a minimum of three competitive grants totaling \$100 million to various entities (e.g., a public entity, private nonprofit entity, or consortium of each) to assist public charter schools in the acquisition, construction, or renovation of facilities by enhancing the availability of loans or bond financing. The program was authorized for one year and \$25 million was appropriated. (A history of federal funding for charter schools is provided in **Table 1**, at the end of this report.)

In June 2002, ED announced the recipients of the \$25 million in Charter School Facilities Financing Demonstration Grants. Five recipients were awarded grants ranging from \$3 million to \$6.4 million to demonstrate credit enhancement initiative to assist charter schools in leveraging capital for the financing of charter school facilities.<sup>10</sup>

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<sup>9</sup> For more information on how related federal programs apply to public charter schools, see CRS Report 97-519, *Public Charter Schools: State Developments and Federal Policy Options*, by Wayne Riddle and James Stedman, pp. 13-20 (archived report; available from author: 7-7382).

<sup>10</sup> For further information and a listing of grantees, see U.S. Department of Education, “Paige Announces Charter Schools Facilities Financing Demonstration Grant Recipients,” *News*, June 6, 2002, [<http://www.ed.gov/news/pressreleases/2002/06/06062002a.html>].



The \$25 million for Charter School Facilities Financing Demonstration Grants was part of a one-time \$1.2 billion appropriation for school renovation and repair in P.L. 106-554. Also included in that appropriation was approximately \$823 million in emergency renovation funds distributed to states, which in turn were required to award grants on a competitive basis, for school renovation. States were required to ensure that schools in high poverty and rural LEAs received a proportionate share of funds. Charter schools classified as separate LEAs were eligible to apply through their state on a competitive basis for these emergency renovation grants.<sup>11</sup>

A small number of charter schools have been provided with funding for facilities financing through the Department of Agriculture's Rural Housing Service (RHS) and through Qualified Zone Academy Bonds (QZAB).<sup>12</sup> Also, public school facilities may be constructed by private entities with financing provided through Qualified Public Education Facility (QPEF) bonds and leased to public charter schools. QPEF bonds are tax exempt facility bonds designed to encourage private for-profit entities to enter into partnerships with state educational agencies (SEAs) or LEAs to construct or renovate public schools.<sup>13</sup>

## **Federal Assistance for Charter School Facilities Under ESEA Title V-B — Public Charter Schools**

The ESEA, as amended by the No Child Left Behind Act (P.L. 107-110), contains two provision under Title V-B — Public Charter Schools (PCS), specifically aimed at providing financial assistance for public charter school facilities. These are Per-Pupil Facilities Aid Programs, and Credit Enhancement Initiatives to Assist Charter School Facility Acquisition, Construction, and Renovation.<sup>14</sup>

**Per-Pupil Facilities Aid Programs.** Title V-B-1 — Charter School Programs (CSP), National Activities, authorizes grants to states to “establish or enhance, and administer, a per-pupil facilities aid program for charter schools in the State.”<sup>15</sup> Under the Per-Pupil Facilities Aid Programs, the Secretary may award competitive grants to states that have per-pupil charter school facilities aid programs specified in state law, and that annually provide financing on a per-pupil basis for charter school facilities. Grants awarded under the program are authorized to be provided over a five-year time frame to supplement state and local funding. The federal share of funding provided through the grant decreases according to a sliding

<sup>11</sup> For more information, see CRS Report RS20171, *School Facilities Infrastructure: Background and Legislative Proposals*, by Susan Boren.

<sup>12</sup> Government Accounting Office, *Charter Schools: Limited Access to Facility Financing*, Washington, D.C., Sept. 2000, pp. 15-16. See also CRS Report RS20699, *Funding School Renovation: Qualified Zone Academy Bonds vs. Traditional Tax-Exempt Bonds*, by Steven Maguire.

<sup>13</sup> QPEF bonds are authorized under the Internal Revenue Code at § 142(a)(13), and rules are provided at § 142(k).

<sup>14</sup> See ESEA Title V-B-1, Section 5205(b) (20 U.S.C. § 7221d(b)); and Title V-B-2, respectively (20 U.S.C. §§ 7223 through 7223j).

<sup>15</sup> ESEA, Title V-B-1, Section 5205(b)(3)(B) (20 U.S.C. § 7221d(b)(3)(B)).

scale over the five-year period. In the first year of the program, no more than 90% of its costs may be met with federal funds, declining to no more than 80% in the second year, 60% in the third year, 40% in the fourth year, and 20% in the fifth year. The non-federal share must supplement and not supplant state and local funding for charter schools. Out of funds appropriated for ESEA Title V-B-1, 100% of the first \$100 million appropriated over \$200 million is reserved for Per-Pupil Facilities Aid Programs, as are 50% of any funds appropriated over \$300 million. In FY2002 and FY2003, no funds in excess of \$200 million were appropriated for Title V-B-1. In FY2004, \$218.7 million was appropriated, providing \$18.7 million for Per-Pupil Facilities Aid Programs. For FY2005, \$17.0 million was appropriated. The Administration has requested \$18.7 million for FY2006.

As noted above, only those states whose charter school laws meet the requirements of the Act are authorized to compete for grants under the Per-Pupil Facilities Aid Programs. As reviews of state charter school laws have identified that not all states with charter school laws provide funding for charter school facilities on a per-pupil basis, only charter schools in select states are able to benefit from the program. In FY2004, four states received funding under the program: California, the District of Columbia, Minnesota, and Utah.<sup>16</sup> Awards ranged from \$1.0 million for the District of Columbia to \$9.8 million for California.

The prospect of providing states the opportunity to apply for competitive grants for per-pupil facilities funding might provide encouragement for states to modify their state charter school laws so that they would meet the requirements of the Per-Pupil Facilities Aid Programs (i.e., by requiring the provision of per-pupil facilities funding). However, some states might be reluctant to amend their charter school law because the costs of providing facilities funding on a per-pupil basis could be greater than the funding potentially made available under the federal program. Thus, the structure of the program could be viewed as using the power of the federal purse to encourage states to adopt policies supportive of charter schools facilities funding.

**Credit Enhancement Initiatives to Assist Charter School Facility Acquisition, Construction, and Renovation.** This program, authorized under Title V-B-2, succeeded the former Charter School Facilities Financing Demonstration Program. Under the program, grantees are required to deposit funds from their grants into a reserve account and use the funds for one or more of the following purposes:

- Guaranteeing, insuring, and reinsuring bonds, notes, loans, or other types of debt that will be used to assist charter schools to acquire, renovate, or construct school facilities that are needed to begin or continue the operation of these schools.
- Guaranteeing or insuring leases of personal or real property that are needed to begin or continue the operation of the charter schools.

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<sup>16</sup> U.S. Department of Education. Office of Innovation and Improvement, *State Charter School Facilities Incentive Grants Program: 2004 Awards*, available at [<http://www.uscharterschools.org/cs/r/query/q/1573?topic=6&type=5&x-title=Facilities>].

- Facilitating financing by potential lenders, encouraging private lending, and other similar activities that directly promote lending to or for the benefit of charter schools.
- Facilitating the issuance of bonds by charter schools or other public entities for the benefit of charter schools, by providing technical, administrative, and other appropriate assistance designed to obtain or attract investors (such as retaining bond counsel and underwriters and consolidating multiple charter school projects into a single bond issue).<sup>17</sup>

Since first being authorized in FY2001, funds have been appropriated for the Credit Enhancements for Charter School Facilities program each year except FY2002 (see **Table 1**).<sup>18</sup> The Administration has requested \$37.0 million for the program for FY2005. ED reports that since June 6, 2002 (when the first grants were awarded under the program), \$87 million in grants made to nine grantees has resulted in \$163 million in facilities financing being made available to 49 charter schools, and in \$1.1 million in lease guarantees to two charter schools.<sup>19</sup>

## History of Federal Funding for Public Charter Schools

Since FY1995, federal funding has been provided for public charter schools. However, funding specifically for charter school facilities has been provided only in FY2001, and FY2003 through FY2005. Historical information on federal funding for charter schools in general, and for charter school facilities, is provided below in **Table 1**.

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<sup>17</sup> U.S. Department of Education, *Credit Enhancement Initiatives to Assist Charter School Facility Acquisition, Construction, and Renovation*, available at [<http://www.ed.gov/programs/charterfacilities/facilitiesguidance2003.pdf>].

<sup>18</sup> In FY2001, the program was called the Charter Schools Facilities Financing Demonstration Grant program.

<sup>19</sup> Untitled letter from Rod Paige, Secretary, U.S. Department of Education, reporting information on the Credit Enhancement for Charter School Facilities program, January 3, 2005.

**Table 1. History of Federal Funding for Charter Schools  
and Charter School Facilities**  
(in thousands of dollars)

Fiscal year	Public charter schools grants (including Per-Pupil Facilities Aid Programs for FY2002 and later) <sup>a</sup>		Credit enhancements for charter school facilities	
	President's request	Appropriation	President's request	Appropriation
FY1995	15,000	6,000	—	—
FY1996	20,000	18,000	—	—
FY1997	40,000	50,987	—	—
FY1998	100,000	80,000	—	—
FY1999	100,000	100,000	—	—
FY2000	130,000	145,000	—	—
FY2001	175,000	190,000	—	\$25,000 <sup>b</sup>
FY2002	200,000	200,000	175,000	0
FY2003	200,000	198,700	100,000	24,838
FY2004	220,000	218,702	100,000	37,279
FY2005	218,702	216,952	100,000	36,981
FY2006	218,702	N/A	36,981	N/A

**Sources:** U.S. Department of Education Budget Service, *Department of Education Fiscal Year 2006 President's Budget*, Feb. 7, 2005; and U.S. Department of Education Budget Service, *Education Department Budget History Table: FY1980 — Present*, Feb. 5, 2004.

a. For FY2002-FY2007, only in instances where the appropriation exceeds \$200 million are funds reserved for per-pupil facilities aid programs.

b. The program first was authorized in the FY2001 Omnibus Appropriations Act (P.L. 106-554).

N/A. Not applicable