Charter School Facility Landscape Analysis in Georgia

January 2019

STATE CHARTER SCHOOLS FOUNDATION of Georgia

LEVELFIELD

PROPRIETARY

Introduction

Level Field Partners (LFP) was engaged by the State Charter School Foundation of Georgia (SCSF) to conduct a landscape analysis of the charter school facility and financing environment with the intent to identify where SCSF portfolio members, and Georgia charter schools more broadly, need assistance in the pursuit of accessing affordable facilities.

As part of the engagement, LFP conducted a market survey of currently-operating state charter schools in SCSF's portfolio[1], supplemented with an interview campaign of **17** state charters to supplement the survey's results[2].

Of the 26 state charter schools[1] invited to complete the survey, **20** responded with 3 respondents in Atlanta, another 7 respondents in the Metro Atlanta area, and 10 respondents from the rest of the state (non-Atlanta/Metro). The pool of respondents current represent 10,843 students, occupying approximately 1.1M square feet in 21 facilities throughout the state.

The purpose of this report is to summarize the findings of the market study while providing insights from other state charter markets and making recommendations as to where SCSF and its network of partners can best support its schools.

Notes: [1] Survey was sent to 26 currently-operating SCSF portfolio members with brick-and-mortar operations, with 20 state charter schools responding; did not include 2 virtual state charter schools and 5 new state charter schools opening in Fall 2019. [2] Interviews were conducted with 17 state charter schools, including 1 new opening in Fall 2019 and 1 virtual

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Key Takeaways

Market Dynamics Impacting State Charter Schools

While Georgia charter schools operate in a market with generally pro-school choice policies, state charter schools struggle to grow enrollment and establish stability due to three interrelated market conditions that impact operations and relegate state charter schools to suboptimal facilities:

LIMITED ACCESS TO PUBLIC SPACE

The inability to successfully access district-owned facilities limits scaling state charter schools' ability to benefit from below-market facility cost structures. This is most important in the first few years of operations as schools are still growing to full enrollment and financial sustainability.

LOW FUNDING & INCONSISTENT AUTHORIZER DYNAMICS

The low funding environment, coupled with crowded statewide authorizing mechanics[1], has invited for-profit turnkey developers and capital providers who promise facilities that are accessible in the first years of operations but that quickly become financially unsustainable.

HUMAN CAPITAL & CAPACITY CONSTRAINTS

State charter schools tend to be single-site entities with limited in-house real estate and financing expertise. At their smaller scale, it is unlikely these organizations have the skill and additional capacity required to initiate and execute on cost-effective development of private facilities.

Resulting Outcomes

- State charter schools are often required to find private facility spaces – usually temporary ones – before even opening their doors due to the lack of district-provided spaces.
- Educators having to work through the challenges of identifying and potentially improving private spaces face a facilities-related knowledge gap, which is particularly exacerbated in the competitive real estate market in greater Metro Atlanta.
- The lack of district facilities indicates a need for incubation and co-location options, particularly important in the first years of operation and in more expensive urban centers.
- While local real estate economics are generally compatible with acquisition and/or development of affordable private facilities, many state charter schools still end up in suboptimal leases and costly turnkey development deals without understanding the full financial implications.
- Furthermore, most of the state charter schools receiving third party support from for-profit groups are forced to settle for sub-par facilities that do not meet their academic / programmatic needs.
- A well-formed network of professional service providers (e.g., lenders, non-profit developers, etc.) to support the state charter schools through their growth and to financial and facility stability is lacking, further heightening the knowledge gap and related impacts.

Source: SCSF-LFP Survey and Interviews

Notes: [1] While there is one state authorizer (State Charter School Commission), each of the 181 districts in the state can authorize their own charters, leading to inconsistent and varied operational norms and approaches to facilities planning and execution.

Key Takeaways: *In Numbers*

Facility Spend

National facility-related spend benchmarks range between 8-14% of public funding. Georgia's state charter schools are spending

12.5%

public funding[1]

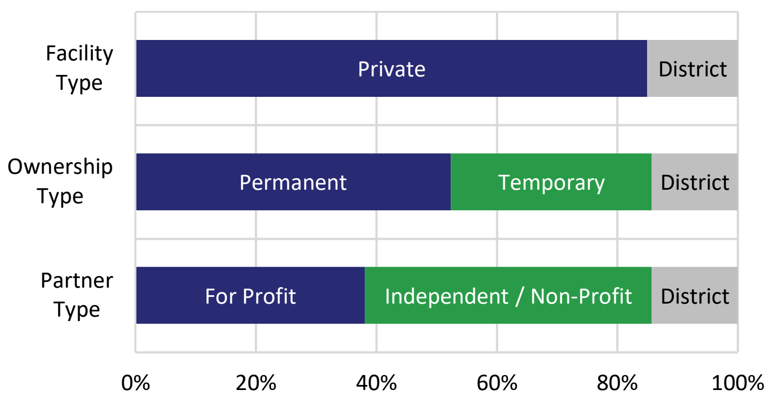
However, spending significantly ranges by facility type…

4.7% **in district facilities[2]**

12.6% **if private facility[3]**

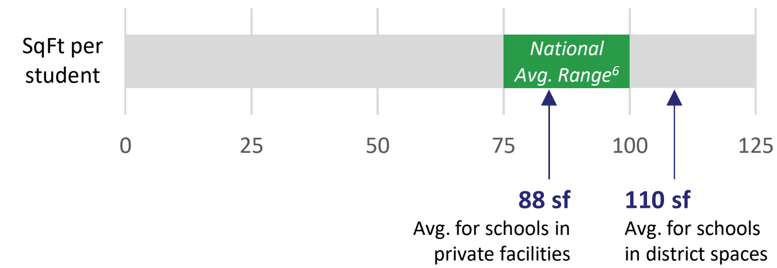
16.8% **if developed by for-profit[4]**

… and most state charter schools are pursuing private facilities due to the lack of availability and access to below-market district-owned alternatives.



Facility Quality

State charter schools are spending more for less…



… and are still missing programmatic spaces vital to successful academic operations.

85% **of survey respondents**

Reported missing **athletic spaces, outdoor spaces, multi-purpose space** or **sufficient classroom spaces**; **65%** reported missing 1+ of these spaces

Facility Financing

Given the prevalence of private facilities, state charter schools are already accessing a wide variety of debt capital…

7 **schools with existing debt that face known financing events**

50%+ **developing with for-profits[5]**

~2x **cost premium when working with for-profit**

… however, there is little consistency among the diverse loan products.

Source: SCSF-LFP Survey

Notes: [1] Based on average funding of $8,500 (n=18); [2] Representative of 3 respondents; [3] Representative of 10 respondents; [4] While 8 properties associated with state charter schools have been developed by for-profit, responses reflected average expense for those still in leases with for-profits (i.e., excludes refinancing) (n=5); [5] Includes turnkey developers and "facility solutions" capital partners; [6] Common range for K-8 sq.ft. benchmark since majority of SCSF state charter schools in private facilities are K-8; high schools tend to be larger (up to 110-125 sf per student), with variation within that range based on geography

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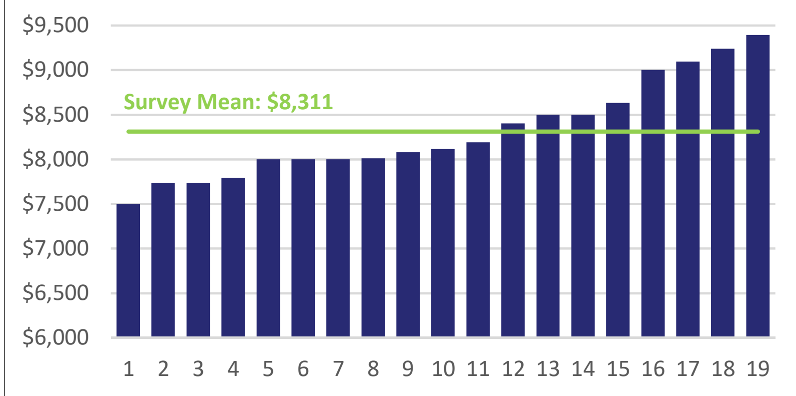
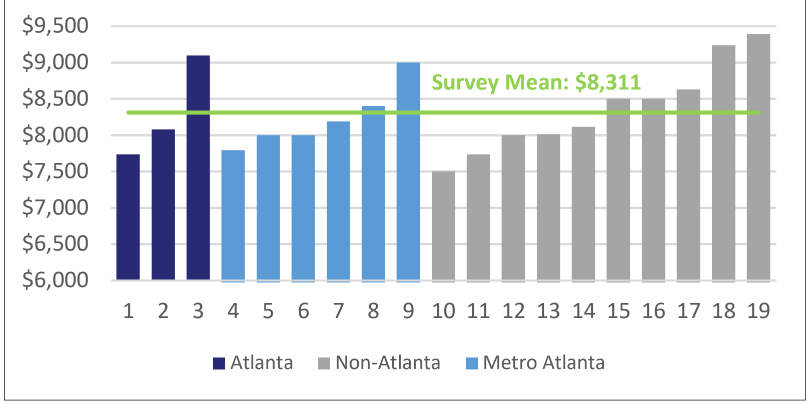
State Charter Funding

- Charter school funding for state charter schools comes entirely from the state, with per-pupil allocations varying based on enrollment, students demographics, physical location, categorical grants[1], and capital outlay. Then, state charter funding is normalized across the state where funding is less than the state-wide average.
- Survey respondents reported FY19 funding levels ranging from $7,500 to $9,400 per pupil; with the average state charter funding set at **$8,311**. Anecdotally, the statewide average funding is expected to be closer to **$8,500**.
- Beginning in 2019, a statewide capital supplement increase will go into effect (HB787).
  - This funding will be subject to a geographic adjustment, with state-approved charters in 'high capital' areas seeing the biggest increase.
  - The State Charter School Commission (SCSC) states average state charter funding for brick and mortar schools, inclusive of the capital supplement, is **$9,257** per pupil in FY19[3].

State Charter Per Pupil Funding[2]





State charters not only receive less than local charters and district schools due to the lack of access to local funding, but state charter schools must also pay large annual rent or debt service payments associated with their privately-developed facilities. Districts generally use bonds and other sources of funding to pay for the acquisition, renovation / construction, and debt service associated with these types of capital expenditures.

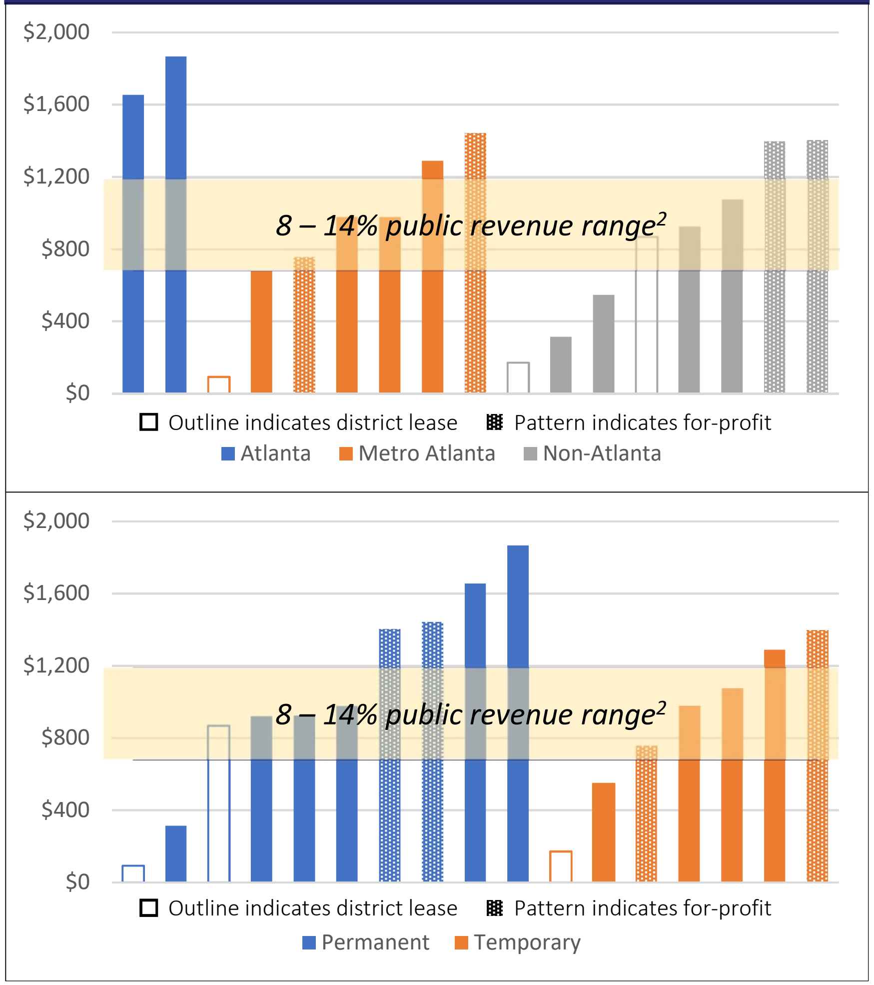
Source: "Georgia Market Analysis" from Ford Research & Solutions; SCSF-LFP Survey Results; Operator Interviews; State Charter School Foundation (scsfga.org); "Georgia lawmakers give state charter schools more money" from Atlanta Journal Constitution (29 March 2018); "State Charter Funding" from SCSC.georgia.gov

Notes: [1] Categorical grants including transportation and child nutrition; [2] Survey question (n=19); [3] From SCSC, avg. funding for all charters after SCSC 1-2% fee

Charter School Affordability

- Nationally, prescribed affordability for privately-developed facilities ranges between **8%** and **14%** of recurring state and local per pupil funding – a cost category not present in district budgets.
- In Georgia, state charter schools receive *on average* **$8,500** per pupil from state sources, with no local funding; this translates into a targeted facility affordability range of between **$680** and **$1,190** per student per year.
- Reported facility expense varied significantly by respondent, with **6 of 17 respondents exceeding the 14% recommended limit.**
  - As expected, facility expenses in Atlanta and Metro Atlanta areas were generally higher than those seen in the rest of the state.
  - Of the four respondents under the 8% lower limit, two are in uncommon below-market district lease arrangements, and one pays twice its annual lease payments in Maintenance & Operations (M&O).
- Among respondents, permanent facility cost structures tend to be in excess of the affordability target, and almost all permanent facilities developed by for-profit partners exceeded the recommended affordability range.

Reported Per Pupil Facility Expense[1]



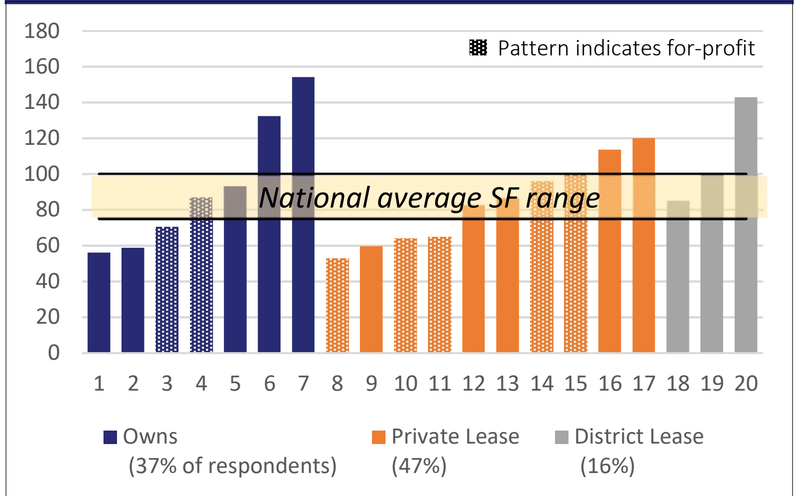
Source: SCSF-LFP Survey Results

Notes: [1] Rent or debt service payments associated with facility occupation; does not include facility-related maintenance and operations expenses; [2] Based on average per pupil state funding of $8,500

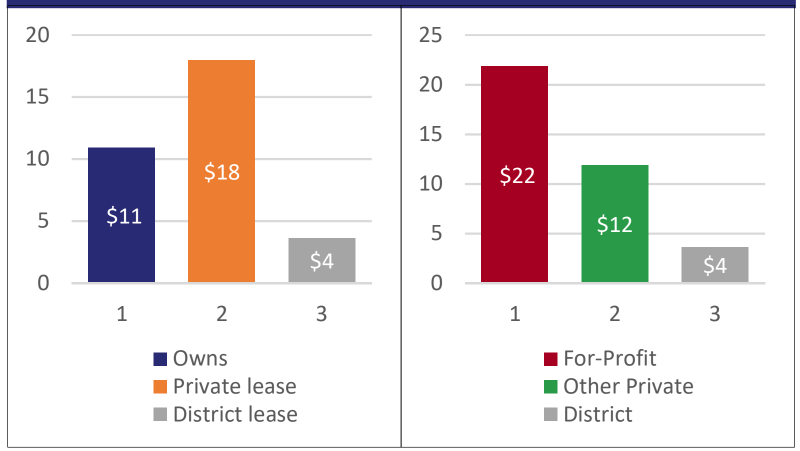
Charter School Affordability

- Despite frequently spending within or above the recommended affordability range, state charter schools generally occupy spaces **similar to or smaller than the national square footage range** (75-100 sf per student).
  - 35% of respondents have less than 75 sf per student, with another 40% within the suggested range.
  - Facilities developed with for-profit partners had an average of just 76 sf per student.
  - Operators able to access district spaces via lease arrangements reported the largest spaces on average at 110 sf per student.
- Comparing on a spend per square foot basis, state charter schools are maximizing affordability if owning **($11 psf)** compared to privately leasing **($18 psf)**, while those partnering with for-profits are spending nearly twice what others are paying **($22 vs. $12 psf, respectively)**.
  - Not captured in this metric is the cost of equity required to pursue the path towards ownership, which often covers up to 15% of facility project costs as a one-time, upfront contribution.

Average Reported Square Feet per Student



Average Facility Expense per Square Foot



Source: SCSF-LFP Survey Results

Presence of For-Profit Facility Players

- Due to low funding and inconsistent authorizer dynamics, human capital and capacity constraints, and limited access to district / alternate facilities, many state charter schools have gravitated towards for-profit turnkey developer / landlords.
- The notable presence of for-profit actors is especially apparent within SCSF's portfolio members as evidenced by the fact that **8** facilities were / are owned by a for-profit group[1].
- These turnkey developers / landlords tend to focus more on achieving their targeted financial returns (10%+) than overall charter school sustainability while imposing lease structures that often make it challenging for charter schools to exercise purchase options – thereby boxing schools into subpar facilities situations and limiting their ability to grow more high-quality seats.

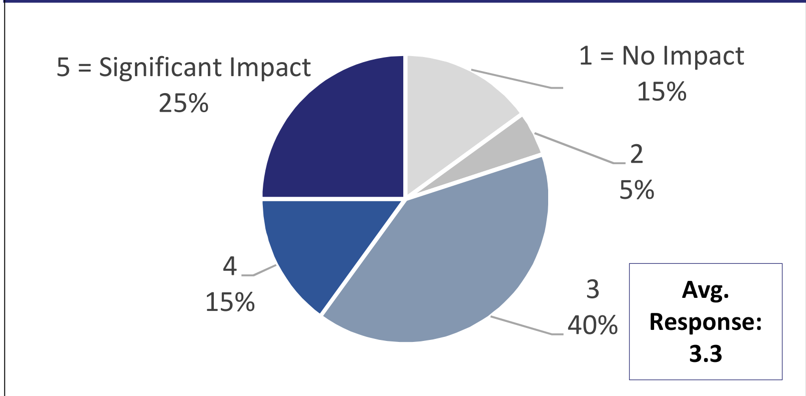
Source: SCSF-LFP Interviews

Notes: [1] In total, 8 facilities previously or currently owned by for-profit groups were identified through research; not all charter schools in those spaces responded to the survey, explaining only 7 identified for-profit spaces on Slide 8

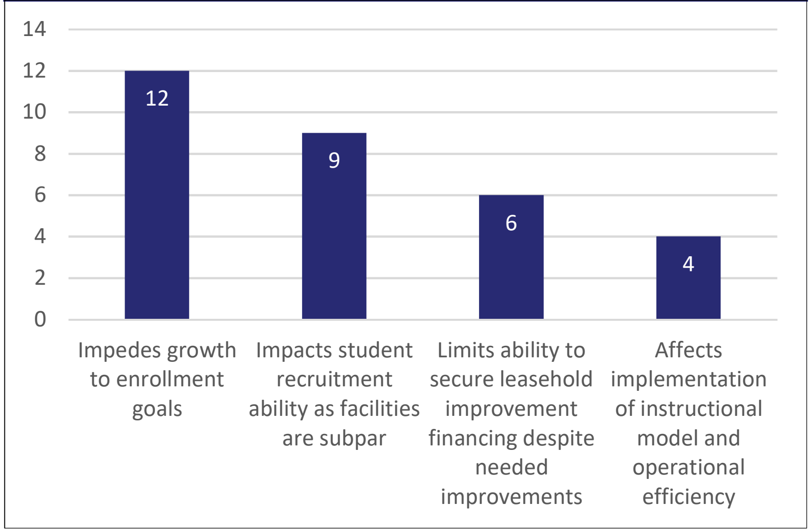
Impact of Inadequate Facilities

- Survey respondents reported that the lack of access to affordable, quality facilities had a notable impact on schools' ability to grow to full enrollment and thereby reach financial stability.
  - Respondents who gave ratings of 1 or 2 either were already in a permanent facility <u>*or*</u> had the option to lease from the district.
  - 100% of respondents who were not in a permanent facility or leasing from a district identified the impact as real to significant (rating of 3 to 5).
- The lack of access to affordable, quality facilities most commonly impacted enrollment, recruitment and instruction.
  - **Impact on student retention**: *The lack of adequate elective program space, especially for high school athletics, contributes to enrollment attrition.*
  - **Current arrangements limit access to growth-related financing:** *It is difficult for the majority of state charter schools, especially those occupying leased spaces, to finance the delivery of additional square footage required for expansion due to insufficient real estate collateral.*
  - **Lack of space impacting morale:** *School staff morale is negatively impacted by a lack of core education / classroom space that results in inefficient scheduling and programming outcomes.*

Impact of Facilities on School Growth[1]



Leading Areas of Impact[2]



Source: SCSF-LFP Survey Results

Notes: [1] Rating of how access to affordable, quality facilities has impacted school (n=20); [2] Leading areas of impact of lack of access to affordable, quality facilities on operations (n=20)

The Right Facility Partners Can Enable Great Outcomes

Case Study: State charter school leveraging qualified partners to successfully execute on delivery of cost-effective permanent private facility

- **Operator Profile:** First-year K-5 school in Metro Atlanta with projected 300-student enrollment at scale
- **Operator Partners:** Charter-focused brokerage firm and related capital sourcing group worked to identify target site while soliciting interest from 21 separate banks for $4.75M acquisition financing, generating interest from 7 lenders
  - Terms from Selected Commercial Bank: $2.75M locked at 5% for 35 years; $2M floating, interest only for first 2 years (extremely favorable terms for first-year charter school)
- **Facility / Project Profile:** 2 buildings totaling about 46,000 sf (1/3 of one of the buildings is not finished and will require approximately $100k of future capital)
  - Creation of outdoor space with installation of small turf field on part of parking lot
  - Operator intends to pursue State Expansion Grant to fund future work
- **Creative Negotiations Led by Broker on Behalf of Operator:** Seller agreed to provide $20k per month credit for 20 months in order to facilitate affordable sale consistent with charter school's scaling enrollment
- **Takeaways:**
  - Even with relatively small transaction, commercial partners did excellent job representing new charter school, setting it up for long-term stability
  - Greater Atlanta Market makes it possible for both (1) affordable commercial acquisitions and (2) decent appraisal outcomes that help attract commercial debt financing

This case study highlights both how state charter schools can close the knowledge gap by partnering with sophisticated commercial partners and the positive impact doing so can have. Despite its lack of facilities experience, this new school succeeded in finding a suitable site, securing cost-effective financing, and setting a path to long-term stability.

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Improving Conditions for State Operators

- In order to reset the current market in a way that enables state charter schools to have better access to affordable private facilities and thereby supports ongoing sector growth, SCSF should pursue a multi-pronged strategy that targets Supporting Legislative Efforts, Improving the Landscape of Financially Sustainable Options, and Closing the Knowledge Gap.
- This section is intended to capture a broad range of potential solutions, understanding that certain recommendations may be more or less viable / attractive to pursue given political or financial dynamics.

Supporting Legislative Efforts	Improving the Landscape of Financially Sustainable Options	Closing the Knowledge Gap
1 Supporting Advocacy Groups to Fund the State Facilities Grant	3 Identifying Preferred Sources of Capital	7 Creating Network of Preferred Service Providers
2 Supporting Advocacy Groups to Expand Access to District-Owned Spaces	4 Pursuing Credit Enhancements for Lenders' Benefits	8 Providing Upfront Training and Ongoing Technical Assistance
	5 Cultivating the Creation of Concessionary / Subordinate Financing Options	
	6 Promoting Incubation and Co-location Opportunities	

Supporting Legislative Efforts

1. **Supporting Advocacy Groups to Fund the State Facilities Grant:** The state charter community should advocate for state officials to fully fund the State Facility Grant program (HB430, 2017), enacted to provide public charter schools with $100,000 block grants to fund necessary facility improvements. Since adoption of this legislation in May 2017, funding has yet to be reserved in the final state budget. The release of the grant funding would materially benefit charter schools as they seek to upgrade existing sub-optimal facilities and would complement other ongoing efforts to reset the local facility and financing market.

   Advocacy could be strengthened through emphasis on potential for reciprocated funds from the federal Facility Incentives Grant program, which matches state-allocated facility funds over a 5-year period.

2. **Supporting Advocacy Groups to Expand Access to District-Owned Spaces**: Despite there being a high volume of vacant public facilities, districts have largely refused to make these spaces available to charter schools. However, as state pension and deferred maintenance costs rise and impose budget pressure on school systems, districts may seek to benefit from transactional arrangements with charter schools in order to alleviate their increasing expense bases.

   Short-term lease access to district spaces would significantly benefit state charters during their financially-challenging ramp-up years, with districts benefiting from charters helping to cover facility operating expenses. Longer-term arrangements – effected through acquisition or 25+-year ground lease – would enable charter access to a variety of debt financing options used to fund necessary improvements to these facilities. This long-term charter access would both relieve districts of any ongoing operating costs and enhance the value of these neglected district-owned assets (if ground lease disposition).

Source: Georgia Charter School Association

Improving the Financial Landscape

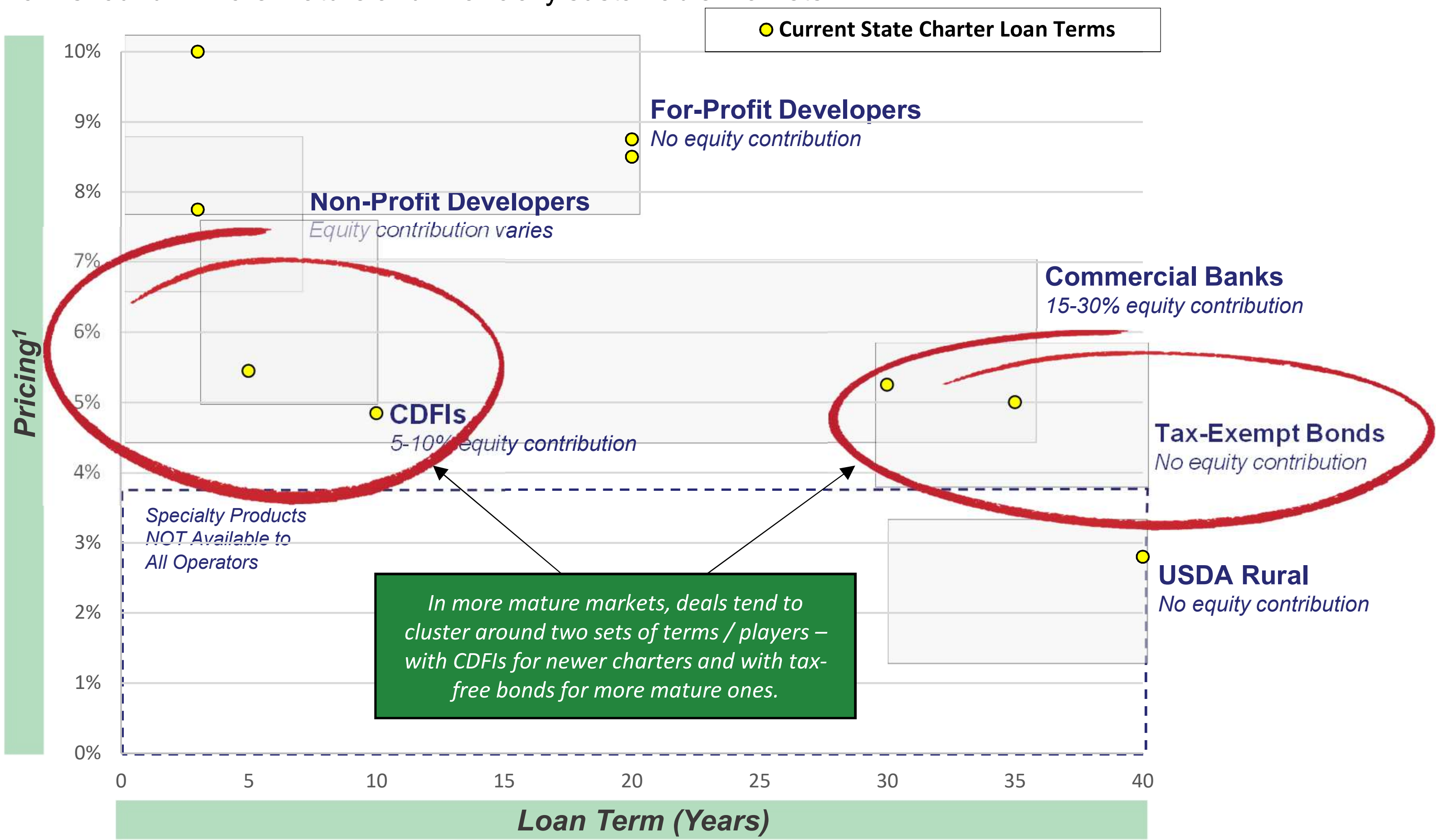
3 **Identifying Preferred Sources of Capital:** In other charter markets throughout the country, charter schools benefit from the presence of a number of local banks and financial institutions familiar with providing affordable financing to non-profits for capital projects. These groups are comfortable with underwriting and making direct loans to the school, as opposed through a third-party partner, such as a developer.

Both commercial banks and Community Development Financial Institutions (CDFIs) are already actively lending in Georgia in other social impact areas, such as low-income housing or healthcare; these groups however, are less active in the charter school space. SCSF should work to cultivate a network of financial institutions that either have strong local ties to the state of Georgia or have proven track records lending to charter schools. SCSF should introduce these groups to the Georgia charter market and the specifics of state charter schools, help them understand the dynamics of the charter school political and funding environment, and support their efforts to begin building a pipeline for potential projects.

It is important to note that unlike turnkey developers, commercial banks and CDFIs typically require an equity contribution of ~5-15% of project costs from the borrower – much like making a deposit when getting a mortgage for a home. While there are ways to help support charter schools in funding these contributions (identified later in this report), charter schools seeking such financing need to be prepared to commit some equity from their cash reserves.

Improving the Financial Landscape, cont'd

In Georgia, state charter schools have typically pursued financing with for-profit developers and commercial banks, with only one state charter school accessing each of the following: CDFI debt, tax-free bonds or a specialty products like a loan from USDA. Creating the network of preferred sources of capital would help align the Georgia market with the terms and norms found in more mature and financially sustainable markets.



Notes: [1] Pricing bands are representative in nature; several factors including credit profile of borrower/project and loan term typically determine each loan's pricing

Improving the Financial Landscape, cont'd

SCSF should explore financial mechanisms that give lenders more comfort with a single-site state charter school's credit profile and help support charter schools to address any required equity contributions. Doing so will help attract financial partners with more favorable terms for charter schools.

4 **Pursuing Credit Enhancements for Lenders' Benefits:** Newly launched charters or those with limited operating history (i.e., less than 2 years) have historically struggled to find affordable debt financing. Recently a number of CDFIs were awarded additional credit enhancements from the Department of Education (DoE) incenting and enabling them to make loans to schools with less than 3 years of operating history at more reasonable rates. SCSF should focus their networking efforts with such CDFIs. To further enhance the overall financing market, SCSF should also explore creating its own pool of credit enhancements to address potential lenders' overall credit concerns, to help cure likely appraisal-driven issues, and to provide lenders with the additional collateral required to secure the loan. SCSF could pursue raising such a pool of credit enhancements directly from the DoE and/or by raising separate funds from other, more philanthropic sources.

5 **Cultivating the Creation of Concessionary / Subordinate Financing Options:** SCSF should explore the viability of partnering with financial institutions and philanthropic sources to establish flexible and cost-effective debt financing options that would help minimize charter schools' equity contributions while still supporting projects' overall viability and maintaining affordability targets. While charter school facility financing often needs subordinate financing to help bridge equity requirements or appraisal issues, the pricing of such subordinate capital reflects risks in those loans. A flexible pool of capital that blends philanthropic sources and those from a CDFI that could be used to fund pre-development activities and reduce charter schools' equity requirements would provide much needed and more cost-effective financing. Multiple charter schools interviewed mentioned the need such sources of capital. An analog of this concept is the dedicated subordinate debt fund the Tennessee Charter School Center and the Low Income Investment Fund (a leading charter-focused CDFI) launched in 2017.

Improving the Financial Landscape, cont'd

6 **Promoting Incubation and Co-location Opportunities:** Due to the lack of access to cost-effective district spaces, charters would benefit from having access to affordable temporary spaces such as dedicated incubation sites or via co-locating with other charter schools, where possible. These short-term alternatives are critical to helping address the significant operational and financial risks faced by new charter schools and provide the following benefits:

- Giving the school time to learn the market better, understand where their families live, and ultimately select a neighborhood best suited for their permanent home.
- Reducing the vacancy costs associated with opening in a building designed to accommodate a much larger enrollment at full scale.
- Reducing a significant underwriting risk as lenders typically struggle to underwrite new schools given the significant enrollment risk and lack of academic results.

In support of incubation space, SCSF should seek to identify mission-aligned partners who would develop, manage, and provide affordable spaces in which schools could incubate for their first 1-3 years before seeking permanent facilities and thereby making room for a new school to move in.

To promote co-location, SCSF should actively engage with all charters to explore opportunities for new schools to co-locate within existing schools for as long as space permits and assuming programmatic needs are aligned. For example, if one state (or locally-authorized) charter school pursues a full project buildout for next year with only 50% of its enrollment, SCSF could help broker a newly launched school to occupy one or two grade levels' worth of classroom space in that same facility.

Both of these strategies would be most viable in an area with a steady pipeline of potential tenants, such as in / around Metro Atlanta.

Closing the Knowledge Gap

Throughout the interview campaign, state charter schools expressed the need for resources, support and training to help guide them through the various stages of the development process. Two areas where the largest benefit will be seen includes:

7 **Creating Network of Preferred Service Providers:** Through proper marketing of sector-wide business opportunities, it is possible to assemble a collaborative and motivated set of real estate and financing partners – one method through which to vet and define the existing service provider landscape would be a Request for Qualification ("RFQ") and interview process. The objectives would be to generate competition and price concessions, ensure quality of service and commitment to the charter school community, and provide charters with quick access to a pre-identified pool of best-in-class professionals. Network would include: commercial brokers, lenders, architecture and design professionals, land use and transactional counsel, construction cost estimators, project managers, and general contractors.

8 **Providing Upfront Training and Ongoing Technical Assistance:** Even with clear access to pre-screened third-party professionals focused on external opportunities, charters will still require initial training relative to "road-mapping" the facilities and financing processes, and definition of feasible / responsible facilities objectives along with requisite execution steps (e.g., targeting the 8-14% of recurring public funding metric; exploring incubator space; establishing true programmatic needs; setting near-term and permanent plans of finance; setting approach for transaction and project team assemblage, etc.). Separately, when a viable facility opportunity arises, the typical state charter school will require some amount of ongoing project-based technical assistance or staff augmentation to ensure optimal execution of the various inter-related critical path activities.

Closing the Knowledge Gap: Training for State Charter Schools

With the majority of state charter schools pursuing private facilities, it is imperative that they receive upfront training to enable clearly-defined and well-informed facilities strategies, the components of which are highly interdependent, non-linear, and unique to each organization. Sample points of consideration are set out below: