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# LEGISLATIVE VICTORIES AND ONGOING CHALLENGES in Texas Charter School Facilities Funding

## Objective

This memorandum aims to provide context surrounding the legislative history of charter school facilities funding for parents and stakeholders to illustrate the great strides that have been made with advocacy efforts to promote excellent school choice options for children in Texas. Without such efforts, charter school facilities and financing options would be sparse, and the efforts are continually important to allow for increased access for high quality charter schools.

## Introduction

Texas open-enrollment charter schools face an operational challenge to secure adequate facilities before they can educate a single student. This challenge places a difficult burden on charters that traditional Independent School Districts (ISDs) are better positioned to address due to easier access to facilities funding. Structural inequities in the Texas school finance system require charter schools to pursue creative solutions to sourcing or building facilities. Many charter schools are forced to address this challenge by diverting money from the instructional budget to make the best out of inadequate facilities.

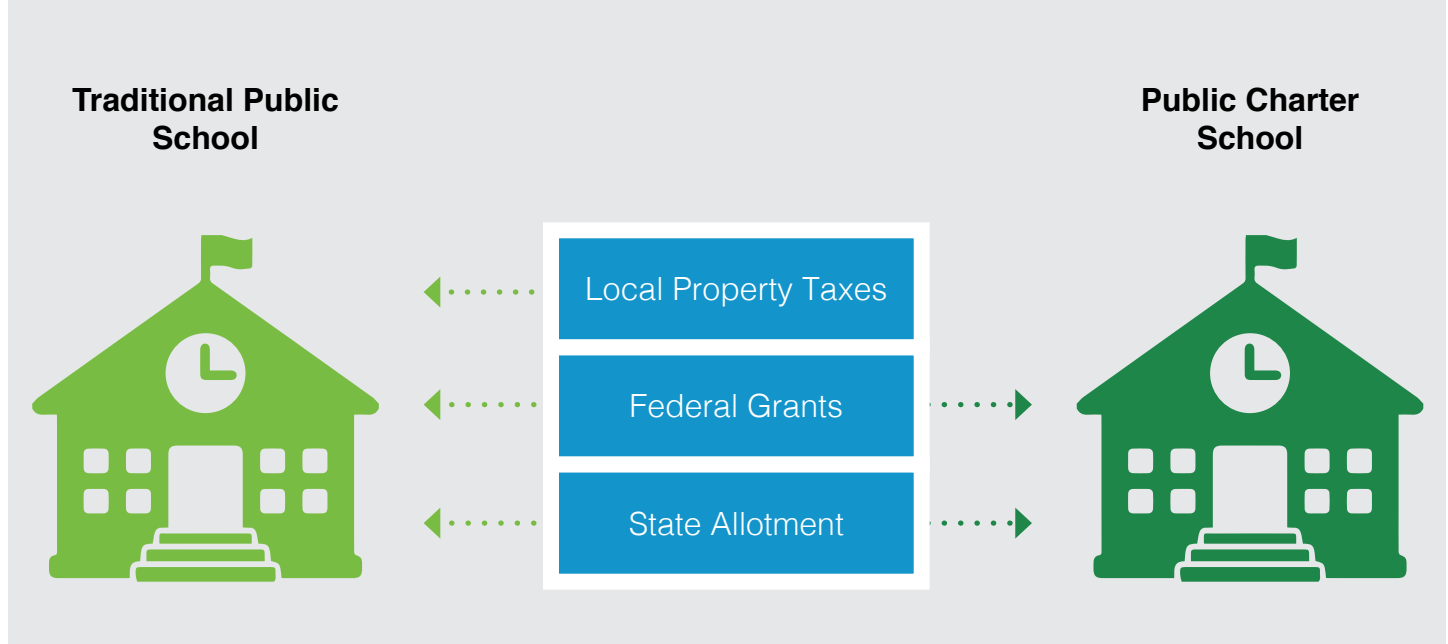
Part of the creative efforts to secure facilities has been charter school advocates successfully lobbying for structural changes in the state's school funding system. Though major structural disadvantages still exist, charter schools now have better access to facilities funding thanks to these efforts. Three of the most consequential developments that this memo will explore are access to the Permanent School Fund (PSF) bond guarantee program, state appropriations for charter school facilities, and partnerships between open-enrollment charter schools and ISDs. This memo will also describe the current struggles of facilities funding and challenges on the horizon.

The importance of legislative gains over the past decade goes beyond charter schools' ability to procure and renovate facilities; charter schools that save money on facilities can then pour that money into instruction. Schools should ideally spend as much of their focus as possible on classroom instruction and student support while having to spend less time jumping through hoops to provide adequate facilities to its students. Discussions on bonds, interest rates, and facilities bills may seem abstract, but the facilities funding landscape impacts students' educational outcomes. Charter-friendly policies have positively affected the approximately 300,000 Texas children they currently serve and have the potential to make an impact on several hundred thousand more down the road.

## Initial Challenges and Access to the Permanent School Fund

Traditional ISDs have three consistent sources of funding: local property taxes, state formula funding, and federal grants. Public charter schools have access to state funding and federal grants, to the extent that they qualify, but do not have the authority to raise money from local property taxes. Part of the allure of charter schools from the perspective of education reformers is the idea of doing more with less but the issue at hand isn't that charter school facilities aren't of the same quality as ISDs; it's that for many charter schools, basic facilities needs aren't being met.

**Figure 1: Sources of Funding**



In 2011, the Texas Charter School Association, the Colorado League of Charter Schools, and the National Alliance for Public Charter Schools conducted a study on Texas's charter school facilities based on a representative sample of survey data. The study found that charter school facilities were below building standards in almost every way. Only 11% of charter schools surveyed met the standard for the physical size of a school based on the number of students they served. More than half did not have athletic fields, libraries, or kitchen facilities that qualified them to serve federally subsidized meals to their low-income students. Also, 40% of charter schools did not have a gymnasium or access to one nearby and 35% of charter schools that serve secondary students did not have a science lab (Colorado League of Charter Schools).

Throughout the 2000s charter school supporters advocated unsuccessfully for the state to fund charter school facilities. To build new facilities, charter management organizations (CMOs) must go to the private bond market or seek large bank loans. Financial institutions typically charge charter schools high interest rates since charter schools are considered riskier borrowers than ISDs. Smaller charter schools are at a greater disadvantage since they often lack a sophisticated board that is experienced in real estate development and real estate finance. Since charter schools are relatively new, many CMOs lack a credit history that would enable them to obtain a lower interest rate. Also, the fact that charter schools operate under an initial five-year contract followed by ten-year renewable contracts adds to lending companies' uncertainty. This problem is exacerbated by strict school closure laws that charter schools face as soon as they open, which makes investors even more hesitant.

To address challenges charter schools face in the bond market, charter school advocates saw a solution in the PSF, arguably the most reliable public endowment fund in the United States. The PSF is an endowment created in 1854 by legislative appropriation for the benefit of Texas public schools. The returns are used to fund schools, and the endowment guarantees bonds held by school districts. When Texas first authorized charter schools in 1995, the state did not grant them access to the PSF bond guarantee program. Charter schools' lack of credit history at the time made the state wary of issuing them PSF guarantees. But as charter schools began to see successful results and some gained enough traction to expand, these schools were able to demonstrate that they were viable candidates to receive the backing of the PSF.

In 2013, Senate Bill (SB) 1 gave charter schools the ability to qualify for the PSF bond guarantee program. The central tenants of the deal that allowed charter schools access to the fund are as follows:

- CMOs with sufficiently good credit and financial standing are eligible to have their bonds guaranteed by the PSF. This guarantee enables them to refinance existing bonds and to obtain a lower interest rate on future bonds.
- The CMO would pay back 10% of their savings on interest payments in exchange for the backing of the PSF.
- Charter schools are eligible to receive a pro-rata amount of PSF guarantees out of the guaranteed funds not already allocated to ISDs. The pro-rata amount is based on the percentage of total Texas students that charter schools serve.

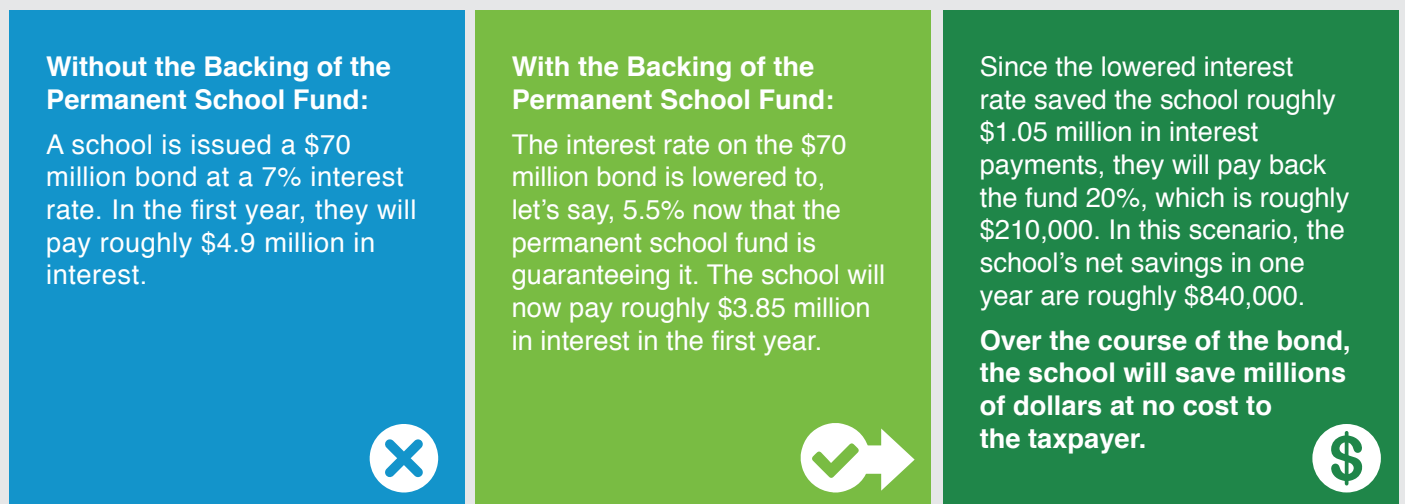
The total amount of guarantees available to Texas schools is the lower of the “Internal Revenue Service Limit,” approximately \$117.3 billion, and the product of the endowment and a multiplier that the state sets. In 2014, the endowment was \$36.325 billion and the multiplier was three, which meant that there were approximately \$109 billion in guarantees available to both traditional public schools and charter schools. Traditional public schools were using approximately \$58 billion, which left charter schools with the pro-rata amount of the remaining \$51 billion. Since charter schools serve about 6% of Texas students, approximately \$3.06 billion were available to them, and traditional public schools would have access to the remaining guarantees.

The state was and continues to be very cautious about which schools received the PSF’s backing and only issues guarantees to CMOs that have received an investment grade rating from a national firm. Still, the PSF quickly issued all the guarantees to CMOs that it was permitted. To make more guarantees available to CMOs, the state raised the multiplier a few times, and it stood at 3.5 as of 2018. These increases made marginal differences, but not enough to keep up with the demands of CMOs. Thus, the regulations were changed under SB 1480 in the 2017 legislative session to allow charter schools more access to the PSF. The new regulations are as follows:

- The proportion of funds charter schools can obtain is based on the entire amount of guarantees available as opposed to only the guarantees not being used by ISDs. In 2018, they had access to about 6% of the \$117.2 billion of available, which is approximately \$7 billion.
- Charter schools must pay 20% of the interest saved upfront.

The stipulation that charter schools must pay 20% of the interest saved upfront was a concession charter school advocates made to strike the deal, but the overall effect was a net win that opened the flood gates of opportunity for charter school facilities funding. By 2017, charter schools that had accessed the PSF had realized an aggregate savings of about \$10.5 million, and savings are expected to grow (Garcia).

**Figure 2: Example of the Permanent School Fund saving money for charter schools**





## Legislative Solutions

Since gaining PSF access, the two most significant bills affecting charter school facilities are from the 2017 legislative session: House Bill (HB) 21 and SB 1882. HB 21 gave \$60 million of facilities funding to charter schools that received an A, B, or C rating from the state's accountability system. The distribution came out to about \$200 per student. HB 21 was the first bill to fund charter school facilities to have passed. While this bill was met with applause from charter school advocates and is seen as an important legislative victory, this money can only solve problems in the short term since it is only a one-time investment. The structural funding disadvantage CMOs face has been somewhat mitigated, but still exists. And though \$60 million may seem like a large sum of money, it is a few drops in the bucket of a multi-billion dollar facilities landscape.

SB 1882 is a bill that incentivizes partnerships between traditional public schools and non-profits that can include open-enrollment charter schools. Some of the bill's stipulations are:

- The partnering organization, such as a CMO, would manage a school in the ISD.
- There is a potential increase in funding from the state for a school that enters into a partnership.
- If the school is in a turnaround partnership, it receives a two-year exemption from some accountability interventions.

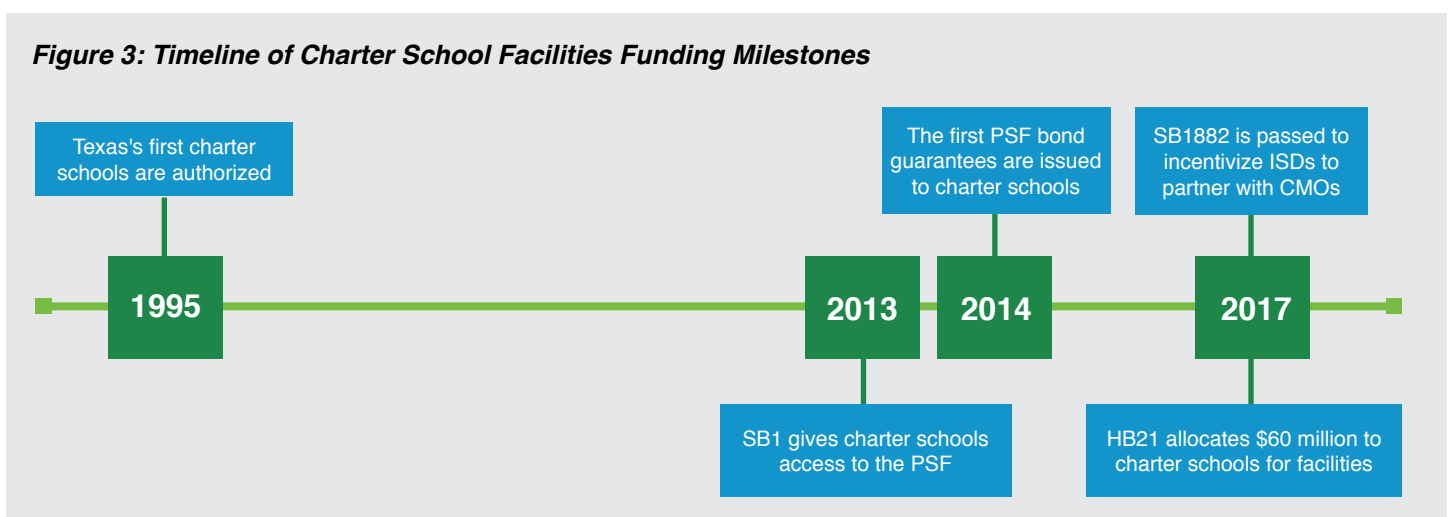
With this kind of partnership, the CMO would solve its facility problem by using the traditional public school's facility. To many, this is seen as a win-win as the ISD would receive the advantage of having the CMO's innovation in one of its schools in addition to any marginal increase in state funding. The ISD would also be able to apply for the Federal Charter Schools Program (CSP) funding and receive funding through the School Action Fund.

The politics of such a partnership, however, are complicated. Charter schools have often advertised themselves as not only additional choices for parents looking for options that best fit their children's needs, but also as direct competitors to traditional public schools. The theory of change under this message is that a competitive market of schools would drive improvement in all schools. But from the perspective of ISDs, charter schools take money from them by taking their resident students, which makes improvement more difficult. The potential for a partnership in this context depends on how collaborative or contentious the relationship between ISDs and charter schools has become in a particular district – or among the district board of trustees.

On its face, it seems that the most likely partnership would involve smaller CMOs serving as partners with ISDs since larger CMOs have better access to philanthropy and the PSF. Also, larger CMOs that have a goal of quickly expanding would be less likely to enter into a partnership with an ISD that will yield the management of one of its schools to the CMO but won't make promises about other schools in the future. However, there is precedent for larger CMOs partnering with an ISD even before the passage of SB 1882.

The SKY Partnership, for example, is a partnership between Spring Branch ISD (SBISD), KIPP, and YES Prep. In this partnership, KIPP and YES Prep run a "school within a school" in one of SBISD's high schools. As for 1882 partnerships, Responsive Education Solutions (RES) is partnering with Beaumont ISD starting in the 2019-20 school year, and IDEA Public Schools will partner with Midland ISD starting in the 2020-21 school year. The idea of a partnership calls to question where open-enrollment charter schools and ISDs will and should stand in the spectrum of collaboration versus competition.

In the 2019 legislative session, HB 3 passed and was signed into law. The law includes about \$6.5 billion in new education spending for both traditional public schools and public charter schools. While this law is a win for all public schools, it does not address the structural funding gap between traditional public schools and public charter schools.



## Current Challenges

Charter school advocates view the near-future legislative sessions as a time when they will have to play defense against anti-charter school bills. One part of the funding system that has caught the eye of some legislators is that urban charter schools are given a larger per-student allotment from the state than ISDs in their area. Larger ISDs are given less money per student than smaller ISDs due to the concept of economies of scale. Open-enrollment charter schools are given an allotment equal to the average per-student allotment across the state. Though large school districts are still given more public money per student than charter schools in their area due to the ISDs' access to local property tax revenue, some legislators are looking to bring the state's per-student allotment for urban charter schools down to the level of the ISDs in the area.

Other points of note are the durability of the facilities that charter schools are building and the nature of the open bond market. Some CMOs have large, sophisticated boards with ample experience in finance and long-term building projects. Others do not, and these smaller CMOs can be a target for a lending company to strike a deal that will put the CMO in a difficult financial situation. Also, CMOs that lack construction management experience run the risk of not adequately addressing the building lifespan. Constructing a 20-year building as opposed to a 50-year building may save money on the front end, but it will ultimately cost more money in future maintenance and renovations.

Also of concern is the fact that municipalities that are hostile to charter schools can prevent charter schools from opening new schools by using permits and zoning. To chip away at municipalities' power to obstruct charter schools, HB 4258 from the 2019 legislative session gives the Texas attorney general the authority to approve bonds to finance an educational facility for a charter school. This bill was made due to concern that some municipalities were refusing to approve the public notice and hearing related to a bond for an educational facility for a charter school.

## Summary

Charter schools have benefitted from the following recent legislative actions to improve access to facilities:

- PSF Bond Guarantee Program: allows charter schools to save money on interest payments on bonds.
- HB 21 Facilities Program: allocated \$60 million to charter schools for facilities funding.
- SB 1882 Partnerships: incentivizes partnerships between ISDs and CMOs.

Though these gains have been made, the structural imbalance that leaves charter schools with less money for facilities remain. Meanwhile, in the aftermath of victories in the 2017 legislative session, charter school advocates are wary of potential anti-charter school bills in the next few sessions. During the 2019 legislative session, there were several anti-charter bills filed, but most of these bills did not pass.

Looking forward, charter school parents, funders, and supporters need to remain vigilant in supporting school choice and equitable educational access for all students in Texas. The political landscape will continue to be tumultuous and engagement in legislative advocacy is critical to combat anti-charter initiatives and future proposed legislation.

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- Garcia, Veronica L. (2017) Charter Victory with PSF Expansion. <https://www.txcharterschools.org/charter-victory-with-psf-expansion/>

