Supplement
Private Financing for Public Education
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Investing in collaboration between public school districts and charter school networks.

BY JESSICA POTHERING

In the back of the auditorium on opening day at Blackstone Valley Prep middle school, a petite woman with closely cropped gray hair seemed an unlikely pioneer of a new model of public school financing.

In the hallways, middle-school students slammed their freshly painted blue lockers and rushed to get into their classrooms before the first bell of the first school year at the newest school in Central Falls, R.I., a down-at-the-heels factory town of fewer than 20,000 people.

Gray skies and drizzling rain didn’t dampen the mood as parents, teachers, administrators, and city and state officials toasted an unprecedented collaboration between a traditional public school district and a network of charter schools. For a moment at least, it seemed that district and charter schools—public schools serving the same families and communities—could not only coexist, but support one another.

Frances Gallo, the former superintendent of Central Falls, did not speak at the opening ceremonies. Under Gallo’s leadership, and against enormous pressure from the teachers’ union, Central Falls became the first school district in the United States to sign a facilities investment agreement as part of a broader District-Charter Compact.

After the event, Gallo explained why she bucked the opposition to welcome charter schools. “I felt I was everyone’s superintendent,” says Gallo, her voice rising. Nearby districts have been attracted to Central Falls’ progress, and more than 20 District-Charter Compacts have been signed across the country, making the vitriol and even death threats she received more tolerable.

The decade-long battle over the expansion of charter schools—public schools operated outside of the supervision and requirements of traditional school districts—has been fueled by competition for scarce education funding. The District-Charter Compacts, supported with $40 million from the Bill & Melinda Gates Foundation, aim instead to share resources and expand the availability of financing while promoting collaboration between the two sectors.

The compacts are the Gates Foundation’s latest strategy in a long quest to improve access to high-quality K-12 education. At the core of the foundation’s facilities strategy are new financing mechanisms to catalyze private financing for public education, strengthening not only the emerging networks of high-performing charter schools, but the resource-strapped public school districts that serve the same communities. In addition to grants, the foundation has provided capital to finance charter school construction on public property and even in former district schools. The compact also obligates charter schools to help the district with teacher training and curriculum and the district to make resources available equitably.

Blackstone Valley Prep is a nonprofit charter school network with 1,400 students that has opened an elementary school and four middle-school campuses in Rhode Island. Its two new facilities in Central Falls are the first schools to open through the new financing strategy. The Gates Foundation made a 10-year, $10 million loan to Civic Builders, a nonprofit charter school facilities developer, to be used for the proj-
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Because charters often receive less public funding per pupil than traditional public schools—$2,247 less per student according to one recent study—private capital markets are vital for financing facilities and construction.

To test its ability to use program-related investments (PRIs) to lower the cost of capital for high-performance charter networks, the Gates Foundation in 2009 provided a $10 million, 10-year credit enhancement to boost the credit rating of a $68 million municipal bond offering by KIPP Houston. KIPP Houston was a reputable CMO that needed financing to build facilities for 7,000 new students. The foundation could have used grants or direct loans, but without the same effect on the marketplace and other investors.

The test worked. Credit-rating agency Fitch gave the bonds an A rating. KIPP received bond orders from 18 institutional investors totaling $210 million—more than three times the amount of its $68 million issue. The credit enhancement resulted in cost savings of 50 basis points, or half of one percentage point. That saved KIPP $300,000 per year.

A second credit-enhancement PRI in 2010 for Aspire Public Schools reassured other investors in the market and secured more attractive lending terms for charters.

As the Gates Foundation demonstrated the potential of credit enhancements to unlock the capital markets for these effective CMOs, others followed suit. Texas created its own bond guaranty program—the Texas Permanent School Fund—financed by oil and gas receipts. That fund, valued at more than $17 billion in 2013, has opened up nearly $1 billion in financing to Texas charter networks. That...
model is being adopted in Arkansas, California, Colorado, Massachusetts, Michigan, Ohio, Utah, and Washington, D.C.

To scale up the potential impact of its education investments, the Gates Foundation backed a specialized school-financing intermediary to source deals, conduct due diligence, structure deal terms and necessary protections, and manage the investment risk. “Trying to kick-start the charter lending market on a transaction-by-transaction basis was not an efficient use of our time,” says Wepman.

In 2011, the Gates Foundation made a $4.3 million low-interest loan to the Charter School Growth Fund as part of a $20 million debt fund to finance charter facilities. The fund supports high-performing CMOs across the country by providing loans to pay for high-cost items like rental payments and facilities financing.

SOCIAL COMPACT
The Gates Foundation believed that charter schools were an important factor in improving the US educational system, but its K-12 program wasn’t a charter-school-only initiative. The foundation’s goals for the US education system also focused on improvements in district public schools.

To combat the perception that the growth of charter schools depleted school district resources, the K-12 Program team devised an unconventional plan to bring the two competing spheres together. An initial $40 million grant and PRI portfolio for the District-Charter Compact has kicked off collaborations in 20 US cities where the foundation has been able to find strong leaders able to bridge long-standing divisions.

Frances Gallo was such a leader. When she first arrived in Central Falls, the new superintendent made a point of visiting the home of every student in the incoming kindergarten class. “As I was knocking on doors, I met many parents who told me their children were in the lottery for the Learning Community,” a promising new charter school. “They felt awkward talking to me.”

In 2011, the Gates Foundation made a $40 million grant and PRI portfolio for the District-Charter Compact team, and against enormous pressure from the teachers’ union, Gallo signed the contract. That made Central Falls the first city with a facilities investment agreement to support charter networks’ access to new school buildings.

The agreement allowed the Gates Foundation to test all its K-12 public education work in one place. The foundation built on its investment in the Charter School Growth Fund by enlisting Civic Builders. The foundation made a $10 million, 10-year loan to Civic Builders to serve as subordinated debt on new school construction projects for Central Falls’ charter schools. That reduced risk for commercial financiers of Civic Builders’ projects, encouraging senior lenders to finance the facilities. With 0 percent interest for the first two years and 2 percent thereafter, the foundation’s loan reduced Civic Builders’ overall capital costs. The savings were passed to the schools as lower rents.

Blackstone Valley Prep became the first beneficiary of the District-Charter Compact’s financial support. Gallo helped identify a nearby public site to build a new elementary charter school, which opened its doors in 2014. A second PRI was used to buy and renovate a second building as a Blackstone Valley Prep middle school. Civic Builders retains ownership of both buildings, leasing them back to Blackstone Valley Prep with the eventual goal of selling them to the charter management organization.

The Gates Foundation will not know the full results of its loan to Civic Builders in Central Falls for some time. But the foundation’s District-Charter Compact effort is showing early signs of having as contagious an effect as its charter municipal bond credit-enhancements. The foundation is now exploring ways to leverage philanthropic and commercial capital on a national level and deploy it through a network of regional intermediaries.

Gallo retired in June 2015, leaving questions about how well the district’s new leadership will work with charter school networks like Blackstone Valley Prep. That uncertainty suggests the next stage of the foundation’s work: encouraging crossover leaders who have worked for CMOs and are now moving into district positions and vice versa. Such leadership may be what’s needed to make the District-Charter Compacts not just a temporary truce, but the basis of a lasting peace. ♦