Department of Legislative Services

Maryland General Assembly
2010 Session

FISCAL AND POLICY NOTE

Senate Bill 738 (Senator Jacobs, *et al.*)

Budget and Taxation and Education, Health, and Environmental Affairs

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Education - Public Charter School Facilities - Financing

This bill establishes the Public Charter School Facilities Debt Reserve Fund to enhance the ability of public charter schools to finance the construction, purchase, and renovation of their facilities by providing (1) leverage to encourage financial institutions to assist public charter schools with financing; (2) security for bonds issued on behalf of a public charter school by the Maryland Health and Higher Educational Facilities Authority (MHHEFA) or a local government; and (3) assistance to public charter schools in obtaining bond financing on favorable terms by specifying a source of money that can be used to make debt service payments if the school fails to make the payments. The State Board of Education is required to adopt regulations to implement the bill.

The Maryland State Department of Education (MSDE) is requested to examine the feasibility of and the mechanism for providing per pupil facilities aid for public charter schools in Maryland and report on its findings by June 1, 2011.

Fiscal Summary

State Effect: General and/or federal fund expenditures to capitalize the Public Charter School Facilities Debt Reserve Fund increase as provided in the State budget; depending on the project's scope and a charter school's financial stability, approximately \$1.0 million may be required to secure financing for each school assisted by the fund. Special fund revenues increase in an amount equal to general fund expenditures and any federal funds or other funds accepted for the benefit of the fund. To the extent that charter schools with loans secured by the fund are unable to pay the debt service, special fund expenditures increase. MSDE can develop the required regulations using existing resources. If MSDE chooses to examine the feasibility of and the mechanism for providing per pupil facilities aid for public charter schools, contractual staff may be needed to conduct the study in FY 2011.

Local Effect: More public charter schools may be able to borrow funds for facilities from banks or from the public market, thereby freeing up funds for operational expenses. Future year expenditures by public charter schools for debt service may increase.

Small Business Effect: Minimal.

Analysis

Bill Summary: The Public Charter School Facilities Debt Reserve Fund consists of federal funds obtained by the State for funding public charter school facilities, money appropriated in the State budget, investment earnings of the fund, and any other money accepted for the fund.

The fund may be used only to (1) provide leverage to encourage the financing of public charter school facilities; (2) serve as security for bonds issued on behalf of a public charter school by MHHEFA or a local government; and (3) serve as debt service guarantee for bonds issued on behalf of a public charter school.

If a charter school fails to make the debt service payments on bonds issued on its behalf, and the fund has a sufficient balance to cover the debt service payment and any other payments or guarantees that the fund is committed to pay, then the State board must direct the State Treasurer to expend money in the fund to pay the principal and interest on the bonds. However, any security or debt service payments under the bill do not create or constitute any indebtedness or obligation of the State or any political subdivision of the State, and the bill does not require the State to make debt service payments on behalf of a public charter school from any source of money other than the fund created by the bill.

Current Law: A local board must disburse to a public charter school an amount of county, State, and federal money for elementary, middle, and secondary students that is commensurate with the amount disbursed to other public schools in the local jurisdiction; however, no capital costs are included in the per pupil amount.

The State board or the local board may give surplus educational materials, supplies, furniture, and other equipment to a public charter school.

The primary public chartering authorities for charter schools are the local boards of education; the secondary chartering authority is the State Board of Education acting in its appeal review capacity or as the public chartering authority for a restructured school.

Background: Public charter schools in 13 states and the District of Columbia receive some manner of state facilities aid ranging from permission to utilize a vacant school district facility in Alaska to a per pupil facilities allotment based on a five-year average of the available capital funds in the District of Columbia. California has a charter school revolving fund that allows charter schools to receive loans for as much as $250,000; schools can use these loans for any start-up costs, including facilities. Utah has a charter school revolving fund that provides loans to charter schools for the costs of constructing, renovating, and purchasing charter school facilities.

States with per pupil aid programs to assist charter schools with their facility costs are eligible for the federal State Facilities Incentive Grant program. The program provides federal funds to match nonfederal dollars used by a state to fund charter school facilities on a per pupil basis. Grants are for five years, and states pay an increasing share of the costs of the program.

In Maryland, charter schools receive per pupil amounts for operational expenses and must use a portion of their per pupil allocation or funds from other sources to pay for capital expenses. There are approximately 42 public charter schools in the State, distributed as follows: 33 in Baltimore City; 4 in Prince George’s County; 2 in Anne Arundel County; and 1 each in Baltimore, Frederick, and St. Mary’s counties.

Several charter schools in the State have gone to MHHEFA for help with navigating the process of obtaining tax-exempt financing for facilities from a bank or the public market. However, charter schools often lack sufficient collateral to secure a loan and the schools are often unable to find interested lenders.

Race to the Top is a $4 billion competitive grant program authorized under the American Recovery and Reinvestment Act of 2009 (ARRA). The program seeks to encourage and reward states that are implementing significant reforms around four specific areas:

- adopting *standards and assessments* that prepare students to succeed in college and the workplace and to compete in the global economy;
- building *data systems* that measure student growth and success and inform teachers and principals about how they can improve instruction;
- recruiting, developing, rewarding, and retaining *effective teachers and principals*, especially where they are needed most; and
- turning around the *lowest-achieving schools*.

Based on the four reform areas, the Race to the Top scoring rubric includes 19 criteria and one competitive priority that collectively add up to 500 points. Several of these criteria account for a large number of points; others account for a comparatively small portion of a state's score. In addition, there are four invitational priorities that states are invited to address in their application, but they will not receive any additional points for doing so. Using these criteria, the U.S. Secretary of Education will determine which states receive grants and the amounts of the grants.

Of the 500 points, a maximum of 40 points are allocated to ensuring successful conditions for high-performing charter schools and other innovative schools. One of the five conditions to meeting that criterion is that the state provide charter schools with funding for facilities, assistance with facilities acquisition, access to public facilities, the ability to share in bonds and mill levies, or other supports while not imposing any facility-related requirements on charter schools that are stricter than those applied to traditional public schools.

Maryland is eligible for up to $250 million of Race to the Top funds. Round 1 applications were due in January 2010. Maryland decided to apply in Round 2 in order to strengthen its application, which is due in June 2010. In accordance with ARRA, the U.S. Department of Education will obligate all funds to states by September 30, 2010. States will then have a four-year project period from the time of the award in which to implement their plans and spend their grant money. At least 50% of the total grant a state receives must be distributed to local school systems. Local school systems and local teachers' union leaders must commit to implementing a state's plan in order to receive grant funds.

Charter schools in Maryland that are located in former public school buildings owned by the local board of education are eligible to receive State public school construction funding. In order to be considered to receive State funding, a charter school capital project must be included in the school system's *Capital Improvement Program*, which must also be approved by the county governing body, and submitted to the Interagency Committee on School Construction (IAC).

IAC makes recommendations to the Board of Public Works (BPW), which makes the final decisions on local school construction projects that receive State funding each year. The proposed fiscal 2011 capital budget includes $255.2 million for public school construction and projects annual finding of $200 million for each of the next four years.

State Expenditures: Based on the only public financing of a charter school to date in Maryland, as described below, approximately $1.0 million in general fund expenditures will be needed to capitalize the Public Charter School Facilities Debt Reserve Fund for each project. Depending on the project's scope and the charter school's financial stability, the amount needed may be greater or less than this estimate since banks and private lenders determine whether to lend money to a particular charter school based on a number of risk factors.

As noted above, Patterson Park Public Charter School (PPPCS) in Baltimore City was able to secure approximately $13.8 million in revenue bonds with a fully funded debt service reserve of approximately $1.0 million, which is approximately 50% of the total maximum annual debt service as determined by Fitch Ratings. The loan payments are a general obligation of the school, secured by a first mortgage on the school's facilities. Fitch rated PPPCS as "BBB" based on the following information.

- PPPCS has an historical positive operating performance, a demonstrated student demand, and the strong support of Baltimore City Public Schools (BCPS). In addition, PPPCS will only need to increase enrollment slightly to meet its debt service.

- Like many charter schools PPPCS has weak liquidity, a high debt burden, and there is the risk that BCPS will not renew its charter, although it has successfully completed one renewal cycle.

- The PPPCS construction risks, are partially mitigated by a guaranteed maximum price contract and an experienced management team.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Maryland State Department of Education; Maryland Higher Education Commission; Department of Health and Mental Hygiene; Caroline and Prince George's counties; Maryland Health and Higher Educational Facilities Authority; *AllBusiness*; Department of Legislative Services

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