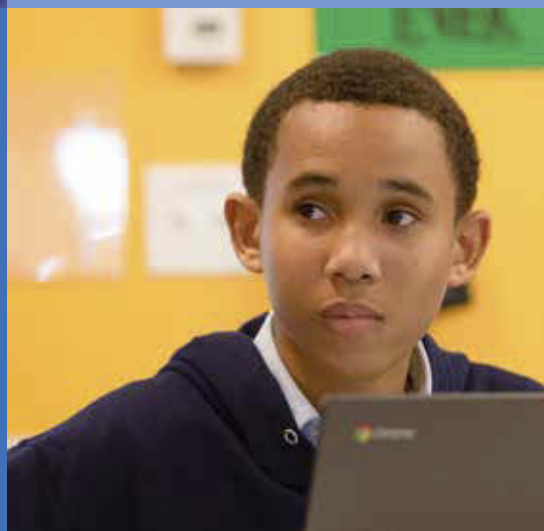




CHARTER SCHOOL FACILITY INCUBATORS



**A CASE STUDY OF
WASHINGTON, D.C.'S
INNOVATIVE APPROACH
TO CHARTER SCHOOL
FACILITIES**



BY PUBLIC IMPACT
TIM FIELD AND TROY SMITH



Acknowledgements

This report is based on Public Impact’s research on the operations and impact of the charter school facility incubator program operated in Washington, D.C. The authors thank the team at Building Pathways for sharing insights and documents about its facility incubator program, and for the many charter school facility experts who contributed their insights to the development of this report. The authors also thank members of Public Impact for their contributions, including Sharon Kebschull Barrett for copyediting and Beverley Tyndall for coordinating the layout and production process. Many thanks to April Leidig for design and layout.

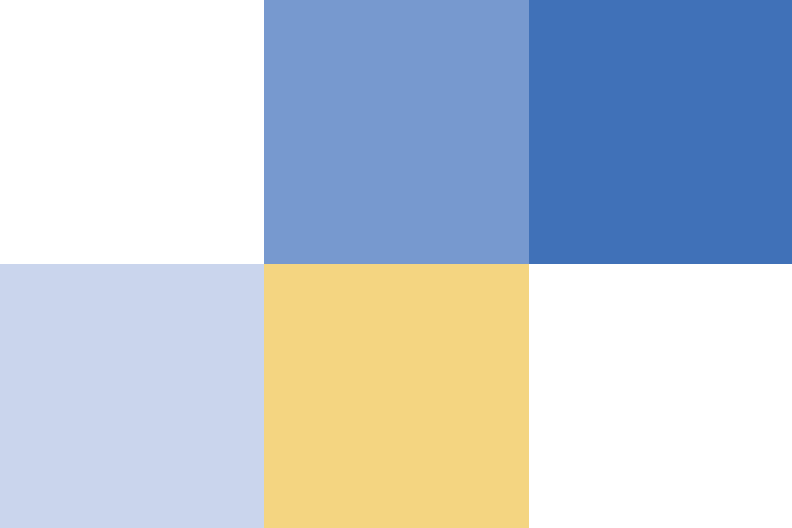
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Building Pathways’ mission is to support the growth of charter schools that offer high-quality education through facility acquisition, modernization, and property management, so that all students—from pre-K to adult—have access to an environment conducive to a promising and successful education.

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INTRODUCTION— THE CHARTER FACILITIES CHALLENGE

 f all the challenges facing new and expanding charter schools, facilities access is arguably the largest and most persistent. A 2012 national public charter school survey found that 56 percent of respondents didn't have access to a building that would be adequate for enrollment in five years.¹

Causes include inadequate facility funding and the scarcity of affordable, suitable buildings in many communities. Many charter schools cannot use state and local funding sources because charter laws limit or prevent them from receiving the same facilities funding as district schools.² In addition, many communities have no available facilities at all, the buildings are ill-suited to school, or the early charter school growth has used up the most suitable, affordable, and readily available facilities. Newly chartered schools must spend years attempting to set aside savings for purchasing a new facility.

Furthermore, the typical founder of a charter school often lacks the expertise needed to effectively solve the facility challenge. School leaders risk making unsound financial commitments for a facility and may find these concerns dominate their time, when they should be focused on hiring staff, creating excellent academic programs, and meeting enrollment targets.

Some facility financing conditions have improved. Some states and cities have enacted policy reforms that increase access to charter facility funding and unused school district buildings. Commercial banks and nonprofit community lenders have become more willing to provide real estate loans to charter schools based on the sector's strong track record of credit worthiness. As a 2014 report from the Local Initiative Support Coalition noted,³ many new private, charter-focused organizations provide a range of services and supports to help charter schools plan, acquire, renovate, and construct schools.

Charter schools' enrollment growth plans also complicate the facilities challenge. Many charter schools start small and gradually expand enrollment and grade levels. These schools require facility flexibility in their early years, and later must weigh the need for more space with the desire to remain in or near where the school began. This, too, can distract charter founders and leaders from focusing on their educational programs.

The Charter Facility Incubator Solution

Creating a charter facility “incubator” can solve these challenges, as the incubator shoulders the responsibility of finding and preparing space for early-stage charter schools. “Incubator” sometimes describes a program that attracts and trains charter founders, and many city- and state-based education organizations have invested in these initiatives. We use incubator to describe a program that provides the physical space for a school—a facility incubator. Having both types of incubators work together makes sense, forming a cohesive approach to starting new charter schools.

But the country has very few examples of facility incubators. Of the 44 charter-friendly states, plus Washington, D.C., only four states have a version of a facility incubator program. The Community Education Building in Wilmington, Delaware, and the Tennessee Charter School Center in Nashville each operate a single facility that provides temporary space for early-stage charter schools, and Denver Public Schools also began providing transitional space to start-up charters after the district ran low on available facilities. The most well-developed example of a facility incubator is the charter school incubator initiative, known as Building Pathways, in Washington, D.C., which has provided short- and long-term space to more than 26 charter schools since its inception in 2006.

Many charter facility experts and leaders of city-based education organizations expressed a keen interest in interviews in understanding how a facility incubator model can be a viable strategy for increasing the availability and quality of charter school buildings.

This case study provides an in-depth look at the design and operations of Building Pathways, and provides insights and guidance to help other cities implement a similar program.



WHAT IS A CHARTER SCHOOL FACILITY INCUBATOR?

Charter school facility incubators provide affordable, short-term space for new and growing charter schools, so that school leaders and board members can focus on academic programs, school operations, and financial health. A facility incubator should provide a full complement of building management and planning services, and set rent payments that are tied to a school's enrollment and ability to pay during its first years.

When schools prepare to “graduate” from an incubator space, facility incubators may also assist with long-term facil-

ity financing, planning, and acquisition through a combination of professional services, including:

1. Planning and designing a new facility
2. Providing credit enhancement or other financial assistance to purchase land or a new building, or renovate an existing facility
3. Selling or leasing a long-term incubator space to a tenant

These functions help the incubator rotate tenants through its spaces and protect the long-term viability of the incubator role.

BENEFITS OF FACILITY INCUBATORS

1. EXPAND OPTIONS FOR FACILITY ACQUISITION

Through ownership and long-term leases, an incubator can acquire new school facilities based on forecasted demand. The incubator is not limited to buildings that meet the capacity needs of a single school and can effectively expand the overall supply of charter school facilities by pooling the demand of multiple schools through co-location (see number 4 below).

2. EXPAND ACCESS TO CAPITAL FINANCING

New charter schools often lack the credit history and assets to obtain long-term leases and financing at competitive rates. An incubator can use its financial standing and scale of operations to expand access to facilities and facility financing for new and growing charters.

3. ALLOW SCHOOLS TO FOCUS ON EDUCATION

School leaders no longer need to navigate a complex facilities system *while also* creating an excellent learning environment. Incubator tenants can focus on education—supporting instructional excellence, recruiting high-quality teachers, and creating a positive school culture.

4. MAXIMIZE USE OF FACILITY SPACE

In co-location, two or more schools share a large space, thus expanding the stock of facilities that charter schools can use.

5. IMPROVE AFFORDABILITY OF SCHOOL FACILITIES

Compared with traditional facilities options, an incubator is very affordable for both new and expanding schools. Rent is

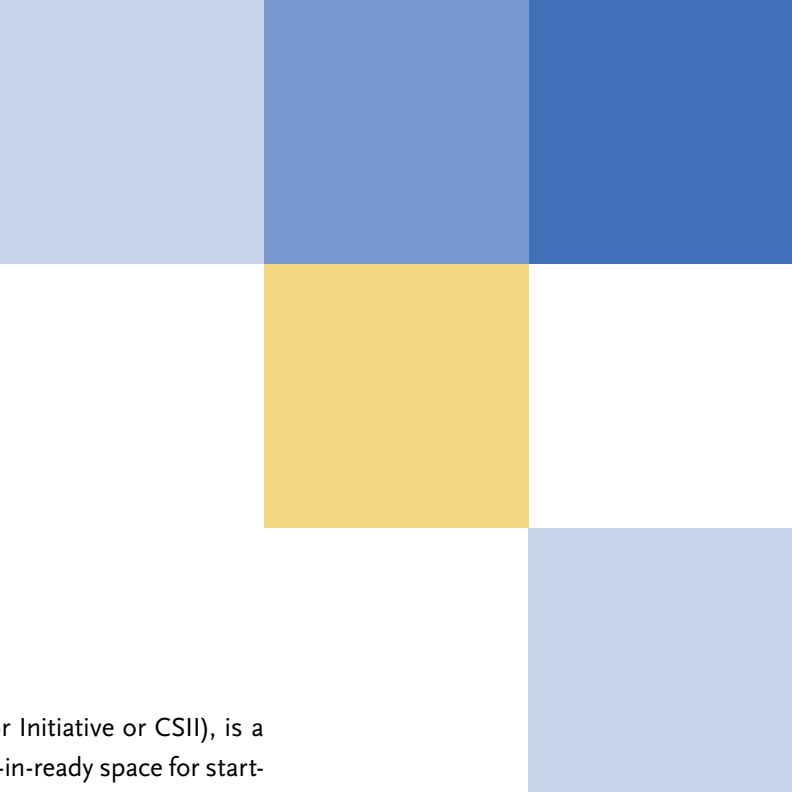
tied to enrollment, which ensures that tenants do not occupy a space that is too big or expensive for their school's needs. Schools shift financial risk to the incubator, which gives the tenant schools greater financial freedom and the flexibility to start small, adding grades and students as they grow.

6. STRENGTHEN TRANSPARENCY & OVERSIGHT OF PUBLIC SCHOOL FACILITIES

An incubator-as-landlord relationship leads to transparent financing and oversight of charter school facilities. This arrangement minimizes the potential for conflicts of interest and nefarious relationships between charter school boards and real estate holding companies that have occurred throughout the sector.

7. EXPAND ACCESS TO PHILANTHROPY AND GRANT FUNDING

An incubator provides additional opportunities for private philanthropy and grant funds to support charter schools. Like a real estate investment trust, the incubator provides a mechanism for philanthropies to invest broadly in the charter sector, rather than selecting individual schools. The incubator also lets foundations make long-term investments in charter schools, since the contributed capital can be recycled to back multiple rounds of facility financing.



WASHINGTON, D.C.— BUILDING PATHWAYS, AN EDUCATIONAL FACILITIES INCUBATOR

Building Pathways (formerly the Charter School Incubator Initiative or CSII), is a nonprofit, independent organization that provides move-in-ready space for start-up or replicating charter schools in Washington, D.C., and serves as the primary facility pipeline for the city's new and expanding charter schools. The District of Columbia Office of the State Superintendent of Education (OSSE) and Building Hope were the original founders of this previously public-private entity.

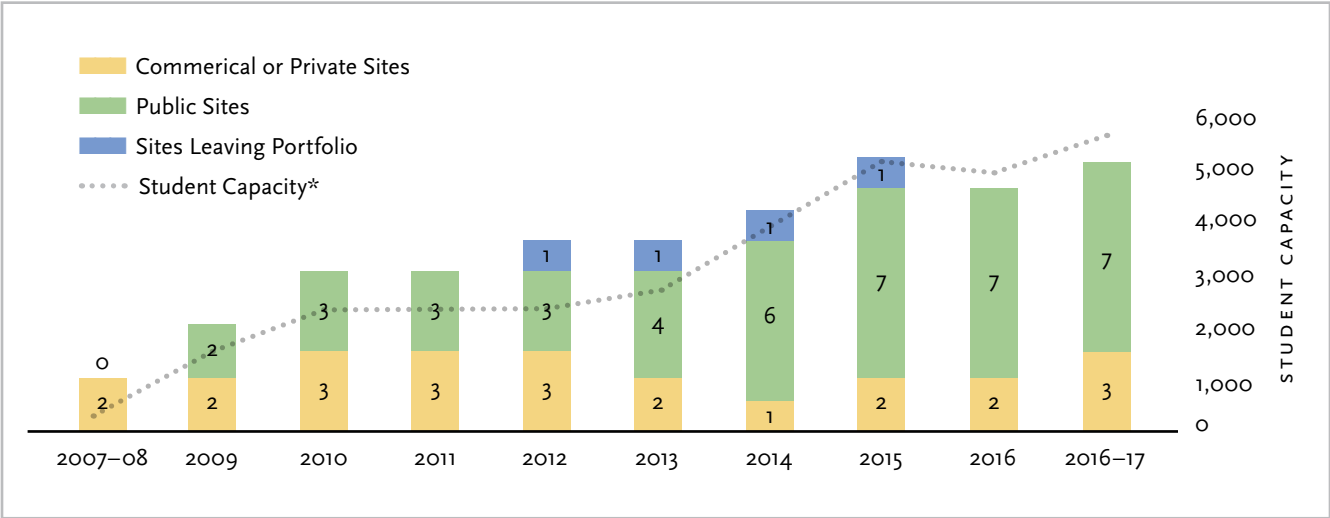
Building Hope, a Washington-based nonprofit, is a charter school community loan fund and community development enterprise. Building Hope was founded in Washington, D.C., in 2003 with a mission to “close the nation’s education achievement gap by providing students with more access to high-quality charter schools.” In a city in which nearly 50 percent of public school students attend charters,⁴ Building Hope provides a variety of facilities services and supports, including financing and financial advising, no-cost technical assistance, and turnkey real estate development. Building Hope also works throughout the Mountain West, South, and Southeast, with offices in Florida, Idaho, and Texas.

OSSE is charged with raising the quality of education for all D.C. residents. It serves as the district’s liaison to the U.S. Department of Education and works closely with the district’s traditional and public charter schools to achieve its key functions, including overseeing all federal education programs and related grants administered in the District of Columbia. In this capacity, OSSE oversees federal grants from the U.S. Department of Education’s Credit Enhancement Program and federal funds related to school choice that are unique to the district’s relationship with the federal government.

Since its inception, Building Pathways has provided access to 15 incubator facilities⁵ totaling over 785,000 square feet, and it has hosted 26 charter schools, including nearly half of all new charter schools opened from 2011 to 2016. Building Pathways has also financed and managed more than \$85 million in incubator facility improvements from 2006 through 2016, and completed \$37 million dollars’ worth of improvements between 2017 and 2018.

Along with other important charter support organizations, Building Pathways has contributed to a high-growth, high-quality charter sector.

Figure 1. Building Pathways’ Facility Portfolio and Student Capacity



* “Student Capacity” refers to the target number of students who could be served by the facility. Actual charter student enrollment levels are very close to the target capacity numbers in any given year.

Figure 2. Building Pathways’ (BP) Charter School Portfolio: Operating Status of Current and Former Tenants

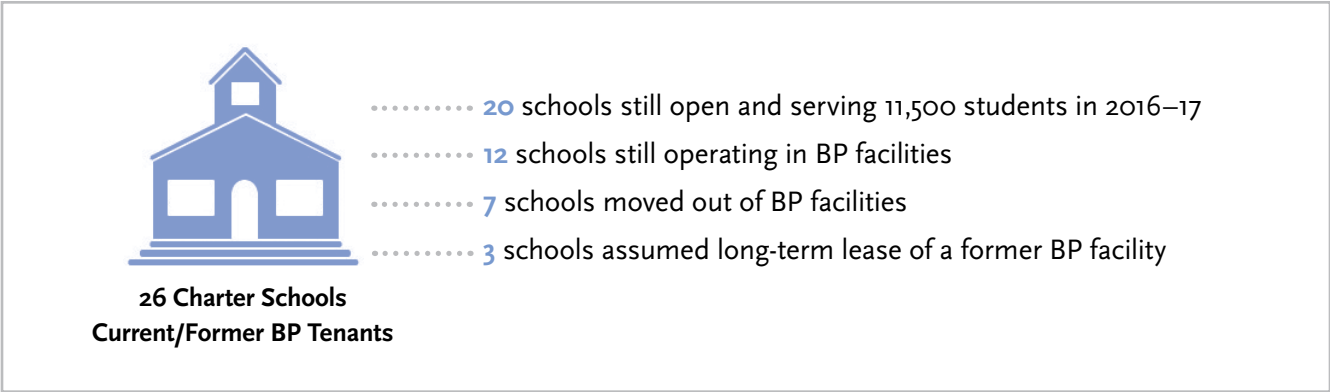
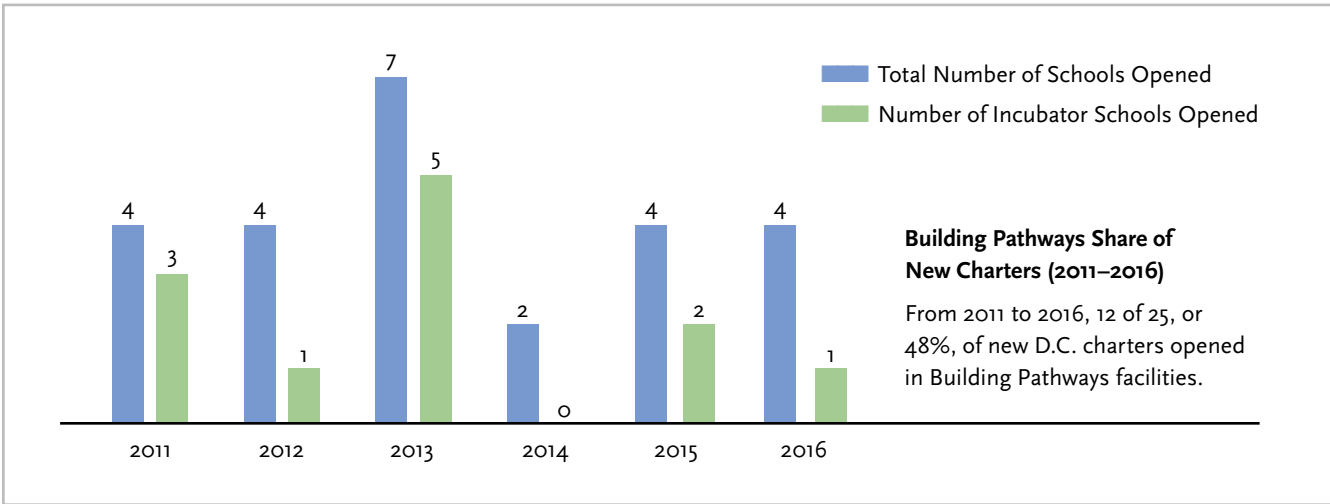


Figure 3. Building Pathways’ Share of New Washington, D.C., Charter Schools Opening in Incubator Facilities



Start-up Funding and Governance

The incubator initiative was developed in 2006 by Building Hope and the DC State Education Office, OSSE's predecessor agency,⁶ after the city received funds from two federal sources. The U.S. Department of Education awarded the District of Columbia a \$5 million credit-enhancement grant through the Credit Enhancement for Charter School Facilities Program in 2004.⁷ One year later, the city received a \$4 million federal appropriation as part of the Scholarship for Opportunity Results Act (or SOAR—formerly known as the DC School Choice Incentive Act of 2003) to develop an incubator facility for public charter schools.⁸ The purpose of charter school sector SOAR Act funds is to improve and expand quality public charter schools in the District of Columbia.⁹ Based on feedback from local stakeholders, the city used SOAR Act funds for a competitive facilities grant that allows high-quality public charter schools to renovate former school district (or other city-owned) facilities that are leased from the city or to renovate charter-owned buildings.

While D.C. had the funding to start a facility incubator, it lacked charter school real estate expertise and, as a governmental entity, faced significant regulatory constraints that limited its ability to acquire and finance facilities. To address these obstacles, in 2006 Building Hope and OSSE's predecessor agency developed the Charter School Incubator Initiative (CSII), now Building Pathways, a separate 501(c)3, combining D.C.'s financial resources and Building Hope's facilities expertise. OSSE (or its predecessor agency) approved all expenditures and reviewed transactions in which Building Pathways was using the credit-enhancement grant—ensuring public oversight of the funds.

Building Pathways secured its initial commercial sites and welcomed its first incubator tenants for the start of the 2007–08 school year. Although these commercial sites met the new schools' basic needs, they were far from ideal. They were expensive, not



Kevin Allen Photo

located in residential neighborhoods, and because they had not been used for educational purposes, they required significant renovations. Although Building Pathways relied on the grant funds to pay for improvements and subsidize the actual cost versus the rent charged to schools, its leaders did not yet have a sound understanding of the long-term prospects of new charter schools, so they did not want to risk long-term commercial leases.

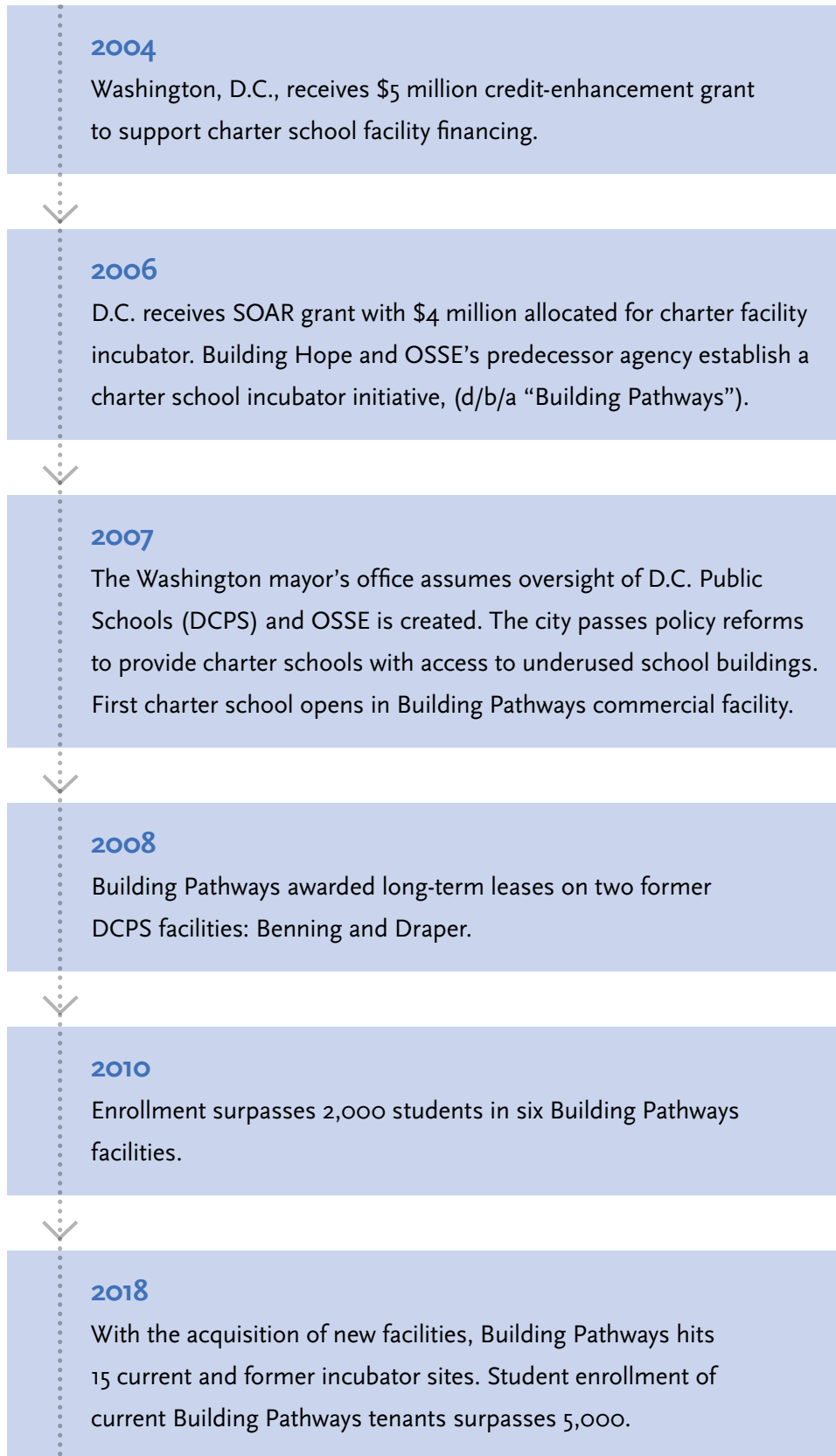
Incubator Growth and Acquisition of Public Facilities

In 2007, Mayor Adrian Fenty's office won final approval from the city council to take mayoral control of D.C. Public Schools (DCPS).¹⁰ Fenty appointed Michelle Rhee as the new chancellor. As one of her first initiatives, Rhee ordered an audit of all public school buildings, which revealed that many schools were severely under-enrolled, leading to the closure of 23 buildings. Thanks to strong advocacy efforts, the city modified its charter law to require that these be offered to public charter schools first. This created a significant opportunity for charter schools to reuse former schools in residential neighborhoods, which provided the spaces commercial sites lacked, such as outdoor areas, gyms, and a cafeteria. Building Pathways won the lease on the first of many former school buildings. For many years, Washington, D.C. maintained a robust, transparent process to competitively bid and award buildings, including public meetings to collect community input. This transparency, along with OSSE's public oversight of Building Pathways, was crucial for maintaining trust and public support for the initiative.



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Figure 4. Timeline of events



HOW BUILDING PATHWAYS WORKS

Building Pathways attributes much of its success and growth to the streamlined process it uses to acquire facilities, guide schools through the application process, usher schools into appropriate spaces, and support schools as they grow and move into permanent facilities. Building Pathways has become the success it is today by providing services and supports that align with the facility incubator benefits outlined in the Facility Incubator Overview on page 13.



Figure 5. Facility Incubator Overview: Building Pathways' Services and Supports

Facility Incubator Benefits	Building Pathways' Services and Supports
Expand Options for Facility Acquisition	1. Acquiring public facilities through multiyear and multi-school planning Building Pathways acquires long-term leases for underused public facilities in Washington, D.C. through a public bidding process. Building Pathways has greatly expanded the number of facilities that can be repurposed for charter schools because it can take on large, multiyear facility projects that are not practical for new and stand-alone charter schools. 2. Converting incubator buildings to permanent facility solutions Building Pathways works to permanently transfer the incubator facilities to charter school incubator tenants that demonstrate academic, financial, and operational success.
Expand Access to Capital Financing	3. Leveraging its balance sheet to finance facility renovations Building Pathways can obtain considerable financing for facility renovations thanks to its longstanding relationships with financial institutions that are comfortable with a higher leverage ratio than a charter school could afford. Building Pathways also maintains a funding model wherein tenant rent payments cover debt obligations.
Allow Schools to Focus on Education	4. Facility planning with new charter schools Building Pathways advises schools on potential incubator sites and provides a letter of support, informing authorities that the school has engaged the incubator to explore its initial facility solution. 5. Managing facility projects Building Pathways provides a move-in-ready facility that matches the school's needs. It manages the site acquisition, lease, and financing, selects the design team, and manages the architect and renovations. School leaders can focus on their education program in their planning year. 6. Providing a full range of facility management services Building Pathways provides a space with all the necessary amenities. It takes on all the facility responsibilities including utilities, building operations, and maintenance. School leaders can focus on education, not property management.
Maximize Use of Facility Space	7. Strategically placing and co-locating incubator tenants Building Pathways uses spaces creatively to maximize the number of high-quality charter schools it can serve. Using its knowledge of facility options, it oversees the process of helping a charter school find the ideal solution either through co-locations, reuse of existing sites, or new sites.
Improve Affordability of School Facilities	8. Keeping fees consistent and affordable Building Pathways ties rent payments to school enrollment and/or debt service based on required renovations, allowing schools to increase their enrollment at a controlled pace. School leaders do not have to pay for a larger facility than needed.
Expand Access to Philanthropy and Grant Funding	9. Providing a scalable and sustainable investment strategy Building Pathways lets investors invest in a single entity that affects the entire charter sector rather than making multiple investments in various school operators. This reduces the transaction costs to philanthropists and the risk level of investing in a single school. It also prevents foundations from giving grants to competing schools, which then bid up the price of real estate.
Strengthen Transparency and Oversight of Public School Facilities	10. Maintaining transparency via public oversight and governance Building Pathways' process for securing and overseeing facilities is open and transparent. All contracts are publicly bid, and all financial records are publicly available.

1. Acquiring public facilities through multiyear and multi-school planning

While the policy reforms that provided Washington, D.C. charter schools with access to public facilities were an important step, Building Pathways has been pivotal in helping schools overcome significant hurdles to acquire and renovate these facilities. It has established a portfolio of incubator facilities that primarily consists of underused public facilities (mostly former public schools), with some commercial sites.¹¹

Many of the available public facilities are too large or need too much renovating for a single charter school to manage. Building Pathways can take on a much broader range of projects by acquiring facilities, financing renovations, and managing properties that serve multiple schools and organizations. Its timeline for securing properties is much longer and more flexible than an individual school; it plans years in advance, before it even knows the charter applicants. As a result, Building Pathways has greatly expanded the number and quality of “surplus” facilities available to charter schools.

ACQUIRING PUBLIC FACILITIES THROUGH WASHINGTON, D.C.’S RIGHT OF FIRST OFFER POLICY

Washington, D.C.’s policy requires the mayor’s office to give the right of first offer to purchase, lease, or otherwise use a surplus school facility to an eligible entity, which includes public charter schools and charter school facility incubators.¹² The process begins when a site is declared surplus or excess by the mayor’s office, meaning: 1) the city has not determined another use for the building, 2) the school system is not using the site for school purposes, and 3) the site has been identified as vacant

or significantly underused. Once the facility is declared surplus, the city issues a request for offers. Building Pathways submits an offer, which describes the incubator program, outlines the project team and qualifications, articulates a plan for facility renovation and tenant placement, provides information on financial feasibility, and describes project implementation. Following community meetings, a review panel gives final approval, and Building Pathways enters into a long-term lease agreement.



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2. Converting incubator buildings to permanent facility solutions

One of Building Pathways' strategies is to permanently transfer some incubator facilities to tenants that have demonstrated academic, financial, and operational success. In fact, Building Pathways often places new tenants in a facility with a long-term plan to transfer the facility to the charter school. It closely coordinates with OSSE and the DC Public Charter School Board (PCSB) on the timing of facility transfers from Building Pathways to charter schools, and helps the school transfer the lease and secure financing to take on any outstanding debt connected to past facility renovations.

Building Hope did not envision this facility transfer strategy in the initial design of Building Pathways, but quickly realized that there were not enough permanent options for schools that started in incubator facilities. Furthermore, by transferring outstanding debt to charter schools, Building Pathways can free up investment capital and credit-enhancement funds for future projects.

3. Leveraging its balance sheet for facility renovations

Building Pathways has leveraged its initial grant investments of \$9 million (SOAR and credit-enhancement funds) to finance over \$85 million for new construction, renovation, and other facility improvements between 2006 and 2018. This level of financing would not have been available to individual charter schools. The condition of newly acquired incubator facilities varies significantly, but most require significant improvements. The Washington, D.C., government does not legally transfer the ownership of former school buildings to outside organizations, but rather offers a long-term lease.

Many commercial lenders are not comfortable with such leasehold mortgages that provide long-term facility renovation loans for property that is leased, not owned, by the borrower. Some lenders simply refuse to consider leasehold mortgages, while other significantly discount the value of the financed renovation and require additional collateral to secure the loan. Over time, Building Pathways has educated lenders on leasehold mortgages; today it has numerous partners that finance incubator facilities under terms that allow a higher debt-to-asset ratio than charter schools can afford.

RENT CREDIT FOR LEASEHOLD IMPROVEMENTS

Washington, D.C. generously provides rent credits for the cost of leasehold improvements to incubator facilities. Building Pathways negotiates the rent credits on a case-by-case basis, either through a letter of intent or pre-development agreement. Typically, the rent credits are equal to one year of rent for every \$1 million of investment. Rent credits dramatically reduce the operating

costs of renovated facilities by allowing charter schools to effectively operate without lease payments for many years of the lease agreement. Funding that would have otherwise gone toward rent is instead used to invest in facility improvements and create a space that best supports a school's program.

4. Facility planning with new charter schools

Organizations and individuals applying to open a new charter school or campus typically contact Building Pathways early in the charter application cycle. They schedule an initial facility planning meeting to learn more about the school (such as its educational model, planned enrollment, and desired location), and to give applicants information about facilities options and incubator program details. The planning process often includes visits to occupied and potential facilities to identify options and better understand the applicant's needs.

An applicant then works with Building Pathways to articulate a facility plan in the charter application. Some applicants will identify a planned incubator facility, while others will list potential locations based on options that Building Pathways has helped to identify. Others simply state that they are in the process of reviewing options with Building Pathways. Given Building Pathways' pricing models, knowledge of local real estate, and capacity to provide move-in-ready space, new charter applicants do not need to dedicate significant time to facility planning in their application.

Building Pathways remains in contact while the application is under review, considering the school's needs in its district-wide facility planning. However, the real work begins on the day the school receives its conditional charter award in May. The school has approximately one year to secure a facility, but the goal is to have a site identified before the district-wide charter school enrollment lotteries take place on February 1 and March 1—just eight months after charter approval.



PROJECT VIGNETTE—DC SCHOLARS PCS

In 2012, Scholars Academies, a Philadelphia-based national charter management organization, obtained a charter to open DC Scholars Public Charter School (DC Scholars PCS). The school aimed to serve preschoolers through third-graders, but was hunting for a larger facility to add grades in the future.

A new incubator space became available when the District of Columbia released a solicitation for Shadd, a former elementary school building, which co-resides with a local food bank and the University of the District of Columbia. Building Pathways worked on behalf of DC Scholars PCS to lease the 72,000-square-foot property and immediately began renovation plans. Building Pathways planned to deliver a fully modernized building by August 2015.

Construction began in April 2015, and Building Hope provided a \$1 million loan and a \$500,000 credit enhancement from America's Charter to finance the "summer-blitz" project. The construction was completed on time and under budget, with almost 100 percent of the contingency unspent.

The school has added a new grade every year, serving pre-K–eighth grade in the 2017–18 school year. Enrollment has steadily increased, with 2017–18 enrollment at 515 students.



PROJECT

DC Scholars Public Charter School

PROJECT DESCRIPTION

Incubator Space

LOCATION

5601 E. Capitol St. SE
Washington, D.C.

CAMPUS OPENED

2015–16 School Year

TOTAL PROJECT COSTS

\$17.5 Million

BUILDING HOPE INVESTMENT

\$1 Million Loan
\$500,000 Credit Enhancement

PROJECT SIZE

72,000 square feet

TENANT

DC Scholars Public Charter School

ENROLLMENT

515 Students (2017–18)

GRADES

Pre-K Through 8th

PROJECT VIGNETTE—DC INTERNATIONAL

The District of Columbia International School (DCI) received charter approval in the winter of 2012. The school had an innovative plan to offer middle and high school students a multilingual and culturally advanced curriculum, and needed a facility plan that would allow it to slowly increase enrollment.

Through Building Pathways, it found a temporary space and acquired a permanent long-term space. Building Pathways negotiated a lease on commercial space in Northwest Washington that gave the school space for three years.

DCI won a bid for the Walter Reed Army Medical Center (WRAMC) campus. The WRAMC project involved fully renovating its 130,000-square-foot interior, plus 35,000 new square feet, into an energy-saving school at a cost of \$50 million.

Opened for the 2017–18 school year, the project provided a state-of-the-art, sustainable educational facility to about 800 students in sixth through 10th grades. DCI plans to add two more grades so that it graduates its first seniors in 2020.



PROJECT

District of Columbia
International School

PROJECT DESCRIPTION

Incubator Space

LOCATION

3220 16th St. NW, Washington, D.C.

CAMPUS OPENED

Temporary space: 2014–15

Permanent space: 2017–18

DEVELOPMENT

Renovate former church building
and construct new two-story
building

TOTAL PROJECT COSTS

\$50 Million

BUILDING HOPE INVESTMENT

\$949,000 Loan

PROJECT SIZE

New Construction: 35,000 square ft.

Renovation: 130,000 square ft.

TENANT

District of Columbia
International School

ENROLLMENT

804 Students (2017–18)

1,450 students at full enrollment
(planned)

GRADES

6th Through 12th at full enrollment

5. Managing facility projects

Once a school receives conditional charter approval and enters its planning year, Building Pathways manages all aspects of facility renovations and readiness. Building Pathways assesses the school’s facility needs given its academic program and projected student population. Some schools require minor modifications to an existing incubator site, while others require more extensive renovations.

Building Pathways contracts with a small number of companies to plan and implement high-quality, competitively priced renovations. Building Pathways usually selects partners, such as the general contractor and architect, through a competitive bid process based on the partner’s record of delivering charter school facility projects in the District of Columbia on time and on budget.

During the renovation and construction processes, Building Pathways provides project support, monitors progress, and manages all finances.

6. Providing a full range of facility management services

Building Pathways gives incubator tenants a full-service lease with complete property management services. The full-service lease offers:

Service	Description
Utilities	Includes all electricity, water, and natural gas
Maintenance & Repairs	Includes the upkeep and repairs associated with normal wear and tear of a facility.
Janitorial Services	Includes such services as daily cleaning, trash removal, kitchen cleaning, power-washing.
Capital Improvements	Includes any facility repairs and upgrades that qualify as capital improvements (such as HVAC replacement)
Technology Infrastructure and Service	Includes installation and maintenance of infrastructure related to technology and Internet connectivity.

Building Pathways contracts with the same service providers for all incubator sites for higher-quality services and better response rates. It also serves as an intermediary between the tenant and service providers if providers are not meeting the school’s needs. The school is responsible only for providing program-specific furniture, fixtures and equipment, security, and phone and data usage.

7. Strategically placing and co-locating incubator tenants

A key element of Building Pathways' success is its knowledge of the city's facilities overall, and its ability to manage the flow of schools in and out of incubator facilities. In assigning schools to incubator sites, Building Pathways gives priority to new schools, followed by schools less than five years old. Building Pathways is focused on maintaining high occupancy rates—essential to financial sustainability. This complex process hinges on Building Pathways' ability to accumulate and track data on:

- Number of new charters in the charter application process
- Current enrollment figures and performance of incubator tenants
- Financial well-being of incubator tenants
- Geographic preferences of both current and prospective incubator tenants
- Potential incubator spaces that have or will soon become available
- Current renovation and construction
- Current space constraints or available room in incubator spaces
- Availability of facilities, as some schools secure other long-term options and move out

Building Pathways uses this information to project facility needs, evaluate available space, match tenants with incubator spaces and other tenants, and acquire and transfer facilities. It tries to make it easy for schools by maintaining a flexible system that monitors the district-wide facility availability and matches schools according to their geographic preferences and projected enrollment.

TENANT TRANSITION & SUBLEASE AGREEMENT

Once Building Pathways and the school agree on an incubator space, they enter into a sublease agreement that outlines the lease length, financial terms, performance requirements, Building Pathways services, co-location expectations, and tenant obligations.

Schools are typically capped at five years in an incubator space, with the expectation that a school will either take over a lease agreement on a permanent basis or identify another permanent facility. When tenants prepare to exit incubator facilities, Building Pathways continues to help schools secure competitive bids for architecture, construction, and facility financing services.

CO-LOCATING INCUBATOR TENANTS

Building Pathways frequently co-locates charter school tenants in its incubator facilities, to maximize its space, serve more schools, and stay financially stable by increasing its rental income. Many of the incubator facilities have hosted co-locating schools. Whether a school will be co-locating is defined in the sublease agreement, which also indicates if one of the schools is slated to take over the space at the end of the sublease term. Building Pathways matches co-locating schools based on desired geography, projected enrollment, and grades served, so that schools with competing grades are not in the same location. Co-location is crucial to the incubator model, but it creates challenges. Schools may find that sharing the same facility leads to scheduling conflicts, space

limitations, or complications in creating their desired school culture. Building Pathways learned the importance of drafting co-sharing agreements among the tenants.

Co-location can be a positive scenario for many schools, as it allows for greater collaboration and resource-sharing. Co-locating often allows a new school to identify a facility within the first few months of receiving a charter. This quick turnaround lets school leaders focus on the program and gives them a competitive edge on enrolling students.

8. Keeping fees consistent and affordable

Building Pathways subleases incubator space to tenants who pay rent based on per-pupil enrollment, rather than on the size of the facility or fair market value. This fee structure allows schools to grow at a manageable pace, cultivate academic programs, and channel the funds they save on rent into educational programs.

Per-pupil rent is based on the targeted facility spending level—equivalent to a facility per-pupil allocation amount (“facility allowance”) provided by the district, minus a withholding amount that helps the school cover facility costs (such as furniture or security) or save for a permanent facility.

BUILDING PATHWAYS’ FEE STRUCTURE

Building Pathways uses the following formula to determine rent for each newly chartered school:

$$(\text{\# of Students}) \times (\text{Per-Pupil Facilities Allowance} - 10\% \text{ school withholding}) = (\text{Rent})$$

The formula is straightforward. The school simply takes the per-pupil amount allotted by the authorizer and multiplies it by the number of students enrolled. The school withholding amount helps schools pay for furniture, equipment, and save for a permanent facility. New schools can withhold up to 10 percent of the per-pupil allowance during the first three years of their charters. The withholding is typically eliminated by year four. For fiscal year 2018, the facility allowance in Washington, D.C., is \$3,193 per student.¹³ So, for example, a first-year school with a 10 percent withholding and a projected enrollment of 100 students would pay:

$$(100 \text{ students}) \times (\$3,193 \times 0.9) = \$287,370 \text{ per year}$$

Washington, D.C.’s per-pupil facility allowance is one of the highest in the nation, comparable only to New York City and New Jersey. However, the facility project costs are also among the highest, at nearly \$300 per square foot.

In states where charter schools receive no or limited facility funding, the facility incubator should consider a targeted facility spending level that is equivalent to a standard percent of per-pupil funding (such as 15 percent). Depending on the local level of charter school funding and average cost of facility projects, the targeted facility spending level may or may not be sufficient for a facility incubator to break even. Set appropriately, the fixed per-pupil rent amount will support financial sustainability for charter school tenants and allow for a stable and scalable financial model for the incubator. Incubators operating in cities and states with less generous funding may need ongoing grants and philanthropic investments to cover operating expenses.

Building Pathways charges tenants using this formula until the tenant finds another facility or takes over the incubator lease on a long-term basis.

Depending on the aggregate school enrollment and actual facility costs, rent may either fall below or exceed overall facility expenses (including lease, maintenance, and debt service on leasehold improvements). Building Pathways uses the excess funds from one facility to cover the shortfalls at others.

Building Pathways realized the importance of explaining this cost structure to schools. Many school leaders were expecting to pay a rate as if their building was the only project being considered. Building Pathways needed to explain that the schools were paying into a portfolio approach where some facilities may be subsidizing others, and all buildings were being subsidized in their first year. This is an “all-for-one, one-for-all” model whereby each school is paying for the overall incubator program.



9. Providing a scalable and sustainable investment strategy

Building Pathways operates a self-sustaining financial model that requires minimal on-going philanthropy to acquire, renovate, and maintain incubator facilities.

OVERVIEW: BUILDING PATHWAYS' OPERATING INCOME

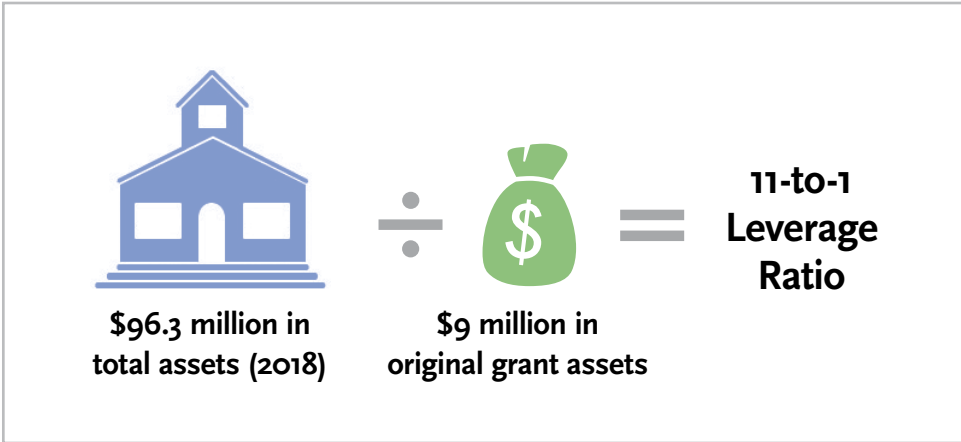
Rent from incubator tenants is the primary source of revenue for Building Pathways. Operating and financing expenses are spread across multiple categories that include: lease payments (minus rent credits for leasehold improvements—see “Rent Credit for Leasehold Improvements,” page 15), property acquisition, principal and interest payments, and property management expenses such as utilities, maintenance, cleaning, and insurance. Although individual facilities may have operating losses or gains in a given year, the overall portfolio generally breaks even over time.

BUILDING PATHWAYS BALANCE SHEET OVERVIEW

As of December 2018, Building Pathways held approximately \$96.3 million in total assets—representing an approximate 11-to-1 leverage ratio against the original \$9 million of grant investments (SOAR and credit-enhancement funds). Building Pathways holds each facility's debt until it transfers the lease to an incubator tenant for the long term, at which point Building Pathways also transfers the debt associated with the facility. Given its success, Building Pathways is seeking additional funds to expand its capacity to finance facility acquisitions and improvements.

Building Pathways allows foundations and philanthropists to invest in a single entity that supports the entire charter sector in a city rather than making multiple investments in individual schools. This reduces the transaction costs to philanthropists and the risk level of investing in a single school. It also prevents foundations from giving grants to competing schools, which then bid up the price of real estate.

Figure 6. Building Pathways Leverage Ratio



10. Maintaining transparency via public oversight and governance

Building Pathways' financial records and audit findings are publicly available. This ensures strong public oversight of the incubator initiative, and was an essential condition that made possible Building Pathways' acquisition of public facilities through the district's public bidding process.

Building Pathways also increases the overall transparency of charter school facility transactions. Charter schools have received criticism and diminished public support when facility purchases and lease agreements appear motivated by profit incentives from private organizations. Building Pathways eliminates this risk and strengthens public and investor confidence in the charter sector.





SUCCESS FACTORS FOR FACILITY INCUBATORS: LESSONS FOR OTHER CITIES

The Building Pathways charter school incubator initiative has been a vital component of the growth and success of the charter sector in Washington, D.C. Organizations wishing to create an incubator model in other cities should evaluate whether these conditions are already in place, and how this affects the viability of a facility incubator strategy in their communities.

- 1. High-quality authorizer.** Washington, D.C.'s Public Charter School Board (PCSB) has established strong accountability systems and new-school authorizing practices that help ensure that only promising, high-quality schools enter incubator facilities. Building Pathways maintains a cooperative, collaborative relationship with PCSB, in which PCSB provides a facility solution for applicants by directing them to Building Pathways.
- 2. Growing, high-quality charter sector.** Since Building Pathways was founded in 2006, PCSB has authorized about four new schools per year, and the charter school market share has grown from 27 percent to 44 percent of K–12 public-school enrollment.¹⁴ This pace of growth has provided Building Pathways with a steady stream of potential tenants and steady demand for new facilities and renovation projects.
- 3. Geographic Proximity of Charter Schools.** Washington, D.C. is a compact community. Furthermore, charter school demand and growth has been concentrated in a few distinct wards within the city. These geographic factors, coupled with the steady growth of the sector, make it possible for Building Pathways to acquire facilities that will serve the long-term needs of many charter school families and school operators.
- 4. Stable and flexible funding.** Building Pathways would not work without the scale and flexibility afforded by the \$4 million SOAR operating grant and \$5 million credit-enhancement fund. The combined amount provides significant leverage for Building Pathways to finance facility projects. The grants are also flexible, not requiring investments in specific schools, targeted funding levels, or prescribed timelines. Private foundations have also invested in Building Pathways.

5. Facility Expertise and Local Knowledge. Building Pathways serves charter schools, facility lenders, and education officials. Although the \$9 million in grant funding was foundational to the program, its success is tied to Building Pathways' expertise in facility lending, capital improvement planning, and property management, but also to Building Pathways' deep experience and familiarity with the local real estate market.

NOTES

1. The National Alliance of Public Charter Schools. (n.d.). *Public charter school facilities: Results from the NAPCS National Charter School Survey, school year 2011–2012*. Retrieved from http://www.publiccharters.org/wp-content/uploads/2014/01/Public-Charter-School-Facilities-National-Survey-Findings_20130905T164026.pdf?x87663
2. Finn, C. E., & Manno, B. V. (2015, June 22). *A progress report on charter schools*. Retrieved from <https://www.nationalaffairs.com/publications/detail/a-progress-report-on-charter-schools>; The National Charter School Resource Center. (2015, April). *An analysis of the charter school facility landscape in California*. Retrieved from https://www.charterschoolcenter.org/sites/default/files/files/field_publication_attachment/Facility%20Landscapein%20California%20April2015_0_0.pdf
3. The Local Initiatives Support Corporation. (2014, September). *2014 charter school facility finance landscape*. Retrieved from http://www.lisc.org/media/filer_public/59/38/5938b90b-07cc-411c-845f-431f50a4682e/2014csflandscape.pdf
4. The District of Columbia Public Charter School Board. (n.d.). Student enrollment. Retrieved from <http://www.dcpsb.org/data/student-enrollment>
5. As of winter 2018, Building Pathways operates 10 incubator sites. Since its inception, Building Pathways transferred two former sites to schools and terminated the lease with three other facilities.
6. The Office of the State Superintendent of Education (OSSE) was established by the Public Education Reform Amendment Act of 2007 (PERRA) to “serve as the state education agency and perform the functions of the state education agency for the District of Columbia.” D.C. Law 17-9, 54 D.C. Reg. 4102 (June 12, 2007), as codified at D.C. Code § 38-2601.01.
7. The credit-enhancement grant was originally awarded to D.C.’s Department of Insurance, Securities and Banking in 2004. It was transferred to OSSE’s predecessor agency, the DC State Education Office, in 2005. *The Credit Enhancement for Charter School Facilities Program* provides grants to charter

organizations and other entities to enhance the credit of charter schools so they can get access to capital to acquire, construct, and renovate facilities.

8. The DC Appropriation Act of 2005, P.L. 108-335, authorized a \$40 million federal payment to the city under the SOAR Act, with \$13 million to be allocated to the DC State Education Office “to expand quality public charter schools in the District of Columbia.” Of the \$13 million, \$4 million was directed to be used for the development of an incubator facility for public charter schools.

9. The SOAR Act also provides funding for District of Columbia Public Schools and the Opportunity Scholarship Program for Washington D.C. students to attend private schools.

10. Nakamura, D. (2007, April 20). *Fenty’s school takeover approved*. Retrieved from <http://www.washingtonpost.com/wp-dyn/content/article/2007/04/19/AR2007041902376.html>; see also: D.C. Law 17-9, 54 D.C. Reg. 4102 (June 12, 2007), as codified at D.C. Code § 38-2601.01.

11. For commercial incubator buildings, Building Pathways works directly with the owner to negotiate lease terms, the length of which is typically much shorter than the 20-year term established for most public facilities. The lease terms often differ according to the age of the building and whether the site is planned as a charter school’s long-term facility.

12. Code of the District of Columbia § 38-1802.09. (n.d.) *District of Columbia public school services to public charter schools*. Retrieved from <https://beta.code.dccouncil.us/dc/council/code/titles/38/chapters/18/>

13. Grosso, D. (2017, May 18). *Report and recommendations of the Committee on Education on the Fiscal Year 2018 budget for agencies under its purview*. Retrieved from http://dccouncil.us/wp-content/uploads/2018/11/Marked-up_Committee_on_Education_FY18_Budget_Report.pdf

14. The District of Columbia Public Charter School Board. (n.d.). *Facts and figures: Market share*. Retrieved from <http://www.dcpsb.org/facts-and-figures-market-share>