Program-Related Investments

Social Investments

The Annie E. Casey Foundation

About the Annie E. Casey Foundation

The Annie E. Casey Foundation is a private charitable organization dedicated to helping build futures for disadvantaged children in the United States. It was established in 1948 by Jim Casey, one of the founders of UPS, and his siblings, who named the Foundation in honor of their mother. The primary mission of the Foundation is to foster public policies, human-service reforms and community supports that more effectively meet the needs of today's vulnerable children and families. In pursuit of this goal, the Foundation makes grants that help states, cities, and neighborhoods fashion more innovative, cost-effective responses to these needs. For more information about the Foundation, visit www.aecf.org.

INTRODUCTION

The Annie E. Casey Foundation is committed to aligning its programmatic and investment objectives. We know that returns on our endowment investments are essential to the long-term success of our grant-making activities. Rather than strive solely for financial returns, however, we allocate a portion of our corpus to investments that enhance our programmatic activity and simultaneously meet our fiduciary responsibilities. We refer to this practice as "social investing," and see it as inclusive of a range of financial instruments such as loans, deposits, loan guarantees, and equity investments.

Social investments present significant opportunities for foundations. For example, at the Annie E. Casey Foundation, we have made major grants to charter-school efforts, including direct support for individual schools as well as the development of application-review programs and accountability processes for schools. However, in the case of facilities financing, we have found loans to be more strategically effective. These loans, as well as a variety of other financial instruments, fall under the rubric of "program-related investments," a type of foundation investment defined by the U.S. Tax Code that is integral to the Annie E. Casey Foundation's social investing strategy.

In these pages, we explore the process and impact of a PRI designed to support large-scale facilities financing in Indianapolis, Indiana. While the investment represents a dramatic merger between our programmatic and financial objectives, the Foundation's social investment is only a small part of a much bigger picture. This is also the story of a group of powerful partners representing the public, private, and nonprofit sectors who have combined their resources and expertise to create an innovative and promising financing model for charter schools.

At a minimum, the Indianapolis Charter Schools Facilities Fund offers great potential to strengthen low-income families and improve outcomes in Indianapolis. For the Annie E. Casey Foundation, we also hope that it might one day serve as a model to make charter schools a scaled component of the educational system in the United States.

Charter Schools Defined

First introduced by the state of Minnesota in 1991, charter schools are tuition-free public schools that operate independently within the nation's existing K-12 school system. Over the last 15 years, the charter movement gained significant traction as an important policy option to address the challenges facing the nation's traditional education system. In 2004, a report commissioned by the U.S. Department of Education confirmed that charter schools are typically smaller than conventional public schools and serve a disproportionate and increasing number of poor and minority students.

By definition, a charter is a performance contract entered into with a sponsoring entity—traditionally a state board of education or local school board—that outlines what the school will attempt to accomplish, how student performance will be measured, and what level of achievement it will attain. In exchange for meeting the terms of such a contract, charter schools are given autonomy and flexibility to design their own curricula, hire their own staff, and control their own budget. As of September 2006, almost 4,000 charter schools were operating across the country serving nearly 1.2 million children, roughly 2 percent of the nation's public school students.

THE CITY OF INDIANAPOLIS & CHARTER SCHOOLS

In 2001, Mayor Bart Peterson took office determined to support and improve Indianapolis' public schools. Like most mayors, however, Peterson had no formal role in overseeing public education. Years of effort by the school system and community leaders had made a difference, but much more was needed. Less than one-half of entering ninth graders in the area's largest school district, the center-city Indianapolis Public Schools (IPS), were on track to finish high school on time.[1]

While passing rates were improving, progress was not happening fast enough—particularly for Indianapolis' poorest families. From Peterson's point of view, charter schools represented a compelling solution to the academic challenges facing the city's most disadvantaged students. It was in this context that Indiana became the 37th state to pass charter school legislation in May of 2001. However, Indiana's charter statute has one particularly unusual feature: It is the first and only state to allow a mayor to create charter schools directly.

Mayor's Charter Schools Office

Shortly after the Indiana General Assembly adopted the charter legislation in 2001, Mayor Peterson created a Charter Schools Office to support his work as an authorizer. This office was charged with day-to-day management of the city's charter approval and monitoring activities. In 2001, the Annie E. Casey Foundation provided a $66,000 grant to fund development of Mayor Peterson's charter-school application-review process. In 2002, the Foundation awarded the city of Indianapolis an additional $375,000 three-year grant to develop a comprehensive charter-school accountability system. Over the total six-year period through 2006, it has invested nearly $700,000 in the Mayor's chartering effort.

As a direct result of these investments, the city developed a model accountability system through which the Mayor's office established expectations, monitored progress, reported to the public, and made informed decisions about the future of the city's charter schools.

The Office's primary oversight tool was its "**Charter School Performance Framework**," built around four evaluative areas[2]:

1) Is the academic program a success?
2) Is the organization viable?
3) Is the school meeting its operations and access obligations?
4) Is the school providing the appropriate conditions for success?

As part of its overall accountability efforts, the Mayor's Office used a range of data-collection methods to execute the school-performance measures outlined in the Framework, including a series of steps (called "prior actions") that must be completed before a school could provide instruction to students, annual standardized testing, independent site visits, parent and staff surveys, and governance and financial reviews, among other requirements.

By fall of 2003, five schools had opened their doors, several more charters had been authorized, and many key elements of the city's accountability system were in place. One area of concern, however, was the city's pipeline of quality charter-school applications. Indiana's charter law allowed the Mayor to grant five charters per annum, but the Mayor's office worried that local community groups would not be able to produce five new quality applicants each year. Specifically, they worried about a constraint not uncommon to charter school developers: Who would cover the facility financing costs?

The Facilities Challenge

While Indiana law provided charter schools statewide with equivalent funding on a per-student basis, the legislation, like that of most other states, failed to address school facility costs. As a result, most charter schools were forced to use a significant portion of their instructional dollars for facilities.

While most public schools are funded through revenue bonds supported by local property taxes, charter schools do not generally have access to the kind of low-interest, tax-exempt debt available to other schools.

The facilities challenge is acute for other reasons as well. School principals often lack a familiarity with the complexities of school finance. Moreover, vacant school buildings are rarely available in good condition or in a suitable location. Often, a space must be adapted or upgraded, which further adds to facility expense. While some charter schools have benefactors to help pay for a building or even donate one, most—especially those in lower-income areas—do not.

The Annie E. Casey Foundation and Education Reform

The Foundation's education investments are driven by the vision of this core result: One day - all young people in tough neighborhoods will achieve the aspiration their families have for them—to graduate prepared for adult success and well being in the worlds of work, family, and citizenship. A key aspect of this is the simple premise that schools are an important community tool for helping individuals and families connect to economic opportunities, social networks, and other public services and supports. From early on, supporting new types of schools and organizations that help schools achieve strong results has been an important part of AECF's approach to education improvement. The Foundation saw significant potential for charter schools to help realize its programmatic objectives in its 10 *Making Connections* communities. Started in 1999, *Making Connections* represented a 10-year investment to improve the outcomes for families and children in tough or isolated neighborhoods.

Several studies clearly demonstrated that opening new schools in troubled neighborhoods can have catalytic effects. Neighborhood children gain access to a new educational option, encouraging young families to move in. Families and other neighbors gain community centers where they can tap into education and social services. As neighborhoods become more attractive to families, businesses become more interested in locating there.

If additional charters schools were to open citywide, the Foundation saw that the potential for economic development and revitalization in Indianapolis would be vast.

Commenting on AECF's Indianapolis involvement, Bruno Manno, Senior Associate for Education, noted, "The Foundation's mission is to improve the lives of the nation's most at-risk kids. These investments gave us a unique opportunity to provide families with more choices of new public schools that meet the highest quality standards. AECF has supported the efforts in Indianapolis right from the start because the Mayor has shown he's committed to taking steps to build an initiative focused on excellence for families and kids."[3]

Finally, because charter agreements are, by design, contingent contracts subject to re-approval once every few years, charter schools tend to encounter resistance and additional charges when they seek to obtain financing from conventional lending institutions. For example, many lenders and landlords perceive these unusual and inexperienced institutions as risky and try to reduce the perceived risk by requiring extra loan guarantees, security deposits, and/or premium rates that the schools typically cannot afford.

This issue resonated deeply with Indianapolis officials. Of the 10 schools operating in 2004, only three had managed to obtain long-term financing for their permanent facilities. To stimulate sufficient supply, the Mayor's Charter Schools Office team knew it had to find a way to address the problem.

IN SEARCH OF SOLUTIONS

Mayor Peterson and his Charter Schools Office teamed up with the Annie E. Casey Foundation to confront the facilities challenge. The national Foundation staff and the local *Making Connections* team were committed to an ongoing charter-school program in Indianapolis and promised to give the issue careful consideration. The question was how to help solve the problem.

Renovating or upgrading an existing space to code for use by a school minimally costs several hundred thousand dollars. Purchasing land and constructing a new facility can be a multi-million dollar endeavor, and that is only if the school can find a willing lender at affordable rates. Regardless, all obvious facilities solutions went well beyond the size of a typical Foundation grant. Even if grants could address the issue, they could realistically be used only in a limited number of cases, which would do little to bring charter schools to scale as an innovative educational solution.

CONSIDERING A PROGRAM-RELATED INVESTMENT

While a traditional grant was an unlikely, if not an impossible solution, there was a far more viable tool at the Foundation's disposal. A Program-Related Investment (PRI) might be considered if the project closely matched the Foundation's programmatic priorities, stable and competent program management and leadership were in place, and a source of funds enabled the repayment on the investment.

Via its local *Making Connections* work and its larger school-improvement efforts, the Foundation had already committed to supporting charter schools as a means of improving outcomes for families and children. Backing the Mayor's charter school initiative could potentially help close the achievement gap for the city's most at-risk students, spur economic development, and work to revitalize the city's low-income neighborhoods.

In the case of Indianapolis charter schools, management and leadership proficiency could be assessed through the charter application process and Charter School Performance Framework. Thoroughly vetting charter applicants on the front-end, monitoring them consistently over time, and working through challenges at the school site substantially ameliorated management concerns at the borrower level. In short, the Charter School Performance Framework ensured that the Foundation's investment would deliver mission-oriented returns while mitigating the Foundation's financial risk. This accountability system would ultimately prove essential to attracting critical partners to the program.

Finally, the Foundation had reason to believe that charter schools presented less risk than real-estate lenders and landlords had previously supposed. So long as a school fulfilled its performance contract and its charter was renewed, its funding stream was effectively guaranteed by the state.

In 2005, when development of the Facilities Fund was already well under way, a study completed by the Kauffman Foundation found the annual school-closure rate to be close to 6 percent. Moreover, the study suggested that even when charters do fail, the re-use rate of facilities was upwards of 96 percent, suggesting that one of the chief concerns of landlords and lenders—an inability to re-market the space easily—had not frequently occurred.[4]

A PRI to support the prospective Charter Schools Facilities Fund in Indianapolis appeared to be a perfect fit for the Annie E. Casey Foundation. By creating several thousand new seats in low-income communities, the schools would have a demonstrable *impact* on the precise families and children the Foundation sought to affect through its programmatic work. If structured correctly, a Foundation-led PRI stood to create substantial *leverage* by strengthening the credit of charter schools with commercial lenders, lowering charter school borrowing costs, and attracting significant private investment. Moreover, if Indianapolis could demonstrate a replicable structure for financing school facilities while simultaneously convincing capital markets that charter schools were a sound investment, the PRI could have national *influence*.

With a variety of financial instruments available, the next step was to determine the most effective type of PRI. Typically the Foundation's PRIs range from between $500,000 to $2 million. Using these funds as a loan, while certainly possible, did not seem to be the most effective use of limited resources. Given the average expense of renovating or building a school, a PRI structured as a loan would only allow one or two schools to receive financing at any given time. In order to generate the impact the Foundation and the city of Indianapolis sought, it was important to find a way to leverage its funds. This would mean employing some other form of PRI and bringing the right partners to the table.

The Mayor's Charter Schools Office felt confident that the Foundation's support would not only enhance the credibility of the city's charter schools with commercial lenders, but also bring market-rate investors to the table. The Mayor's team also suspected that the city might also be able to attach its strong credit rating to charter schools, thereby lowering the schools' borrowing costs. Out of these brainstorming sessions, the notion of a Charter School Facilities Fund, co-sponsored by the city of Indianapolis and the Annie E. Casey Foundation, and designed to provide affordable financing for charter-school facilities, was hatched.

Program-Related Investments

In 1968, the Ford Foundation pioneered the field of PRIs by making direct, below-market-rate charitable loans to organizations that were a part of its program focus. The U.S. Tax Reform Act of 1969 legally defined the investments as an outlay by a foundation that can generate financial return but primarily supports a charitable project or activity. To be classified as a PRI, the investment must meet the following three criteria: 1) Its primary purpose must be to further the tax-exempt objectives of the foundation, 2) the production of income or the appreciation of property cannot be a significant purpose of the investment, and 3) the investment cannot be used to support lobbying or political campaign activities.[5]

From a foundation's perspective, even beyond the expected financial return, PRIs are extremely valuable tools. In the United States, foundations are required by law to distribute 5 percent of their endowments annually. Referred to as the "payout," this requirement is typically met in the form of grants. However, when the legal conditions are met, PRIs are also qualifying distributions.

While loans are the most common PRI instrument, making up more than half of PRIs made, a PRI transaction can use a number of investment instruments. These include mission-related deposits, loan guaranties, lines of credit, asset purchases, equity investments, or recoverable grants.

The Indianapolis Charter Schools Facilities Fund would be the nation's first city-developed, comprehensive charter-school facility-financing program. The program would be designed to make up to $20 million in loans available to qualified charter schools for the acquisition, construction, renovation, and leasehold improvements of facilities.

FINDING THE RIGHT PARTNERS

For policy reasons, all of the Foundation's PRIs must flow through intermediaries, never to schools or individuals directly. For practical purposes, the team would also need a partner with significant experience financing public projects in Indianapolis.

The Indianapolis Bond Bank

Created in 1985, the Bond Bank's primary purpose is to serve as a financing instrument for public works in the city of Indianapolis. The Bond Bank does not generally lend money but instead issues bonds and other debt instruments on behalf of various city agencies. Over time, the Bond Bank's role has expanded to include overseeing major economic development projects on behalf of the city, working with the Mayor's Office on strategic financial matters and, in particular, issuing and managing debt. In 2002, largely at the urging of Mayor Peterson, the Indiana General Assembly amended the Bond Bank's statute in order to allow the Bond Bank to issue debt on behalf of charter schools.

While the Bond Bank's public finance expertise and recent experience in the charter arena were important, one of its most promising offerings was access to low interest rates via the city's AA credit rating.[6] By using the Bond Bank as an intermediary, the city of Indianapolis could attach a "moral obligation pledge" in connection with any debt issued on behalf of the Facilities Fund. In the simplest terms, the moral obligation pledge is similar to insurance.

Were it to make such a pledge, the city would have a moral, but not legal, obligation to cover any cash shortfalls for debt-service payments in the event that a participating charter school defaulted on its loan. Because failure to honor the obligation would *severely* jeopardize the municipality's credit rating, lenders interpret moral obligation clauses as a credible signal of assured repayment. This assurance, in turn, allows financial institutions to offer borrowers extremely advantageous interest rates. Though the Bond Bank could not affix Indianapolis' moral obligation without the City-County Council's approval, executives felt confident that a measure would pass if the proposed Facilities Fund was structured properly and had the Mayor's support.

Local Initiatives Support Corporation

In Indianapolis, it became clear that a partner with a deep understanding of charter school finance and school facilities would be necessary. The Local Initiatives Support Corporation (LISC) quickly emerged as an obvious thought partner and co-investor.

As the nation's largest community development financial institution, LISC combines corporate, government, and philanthropic resources to help nonprofit community development organizations revitalize underserved neighborhoods by providing capital, technical expertise, training, and information. While LISC is a national organization, it has a community-based focus. Program staff members are based in every city and many of the rural areas where LISC-supported community development takes shape. In collaboration with community groups, LISC staff help identify local priorities and challenges, delivering the most appropriate support to meet local needs.

LISC had been working with Indianapolis' charter schools since the state passed its charter-school legislation. As a Senior Program Officer with LISC Indianapolis explained, "Charter schools are generally started by educators; they are great at teaching kids, but they do not know nearly enough about building a school facility or getting it financed. LISC's value locally is that, as technical assistance providers, we can get these schools ready to be borrowers. Playing that intermediary role is hard; it is unconventional. Banks simply don't have the time or resources to devote to that kind of work, but we do."[7] By providing local schools with direct technical assistance and loans, assisting them in evaluating facilities, and helping charters build organizational capacity in areas of board governance, fund raising, and real estate development, LISC Indianapolis had quickly established itself as the source of local expertise.

LISC was an equally valuable partner at the national level. In 2003, LISC launched the Educational Facilities Financing Center (EFFC). Through the EFFC's Loan & Guaranty Fund, LISC invested in the creation and/or expansion of local financing funds that supported the facility needs of charter schools in particular markets. Through the EFFC's Seed Fund, LISC provided capacity building and predevelopment recoverable grants to charter schools via local LISC offices and other suitable organizations. As of 2006, LISC had closed almost $20 million in loan and guarantees to seven unique local financing funds and committed almost $1 million in Seed Fund companion grants to support five of its loan and guaranty investments.[8]

After initial conversations with the Foundation and the Mayor's team, LISC agreed to match AECF's investment in the proposed Fund. Though the specific financial tool was still undecided, AECF and LISC had each tentatively agreed to invest one million dollars, expecting that their money would most likely take the form of a loan guaranty—that is, a promise by the organizations to repay a borrower's debt should that borrower default on the obligation. A loan guaranty was thought to offer the ability to leverage available funds by enhancing the credibility of the city's charter schools with commercial lenders, and it would maximize the impact by bringing market-rate investors to the table. Additionally, utilizing a loan guaranty meant that funds would only be drawn down in the case of default and never actually lent out to the schools for construction needs.

Equally important, LISC's local leadership brought substantial public and private finance experience to the team, making LISC an even stronger co-investor and thought partner. With support from LISC at the local and national level, it was initially estimated that the Facilities Fund would be able to raise $20 million and support 15-20 school construction projects over the following five years.[9] Ultimately, this would mean the creation of approximately 4,000 new seats for Indianapolis' struggling, low-income students and the revitalization of several of the city's poorest neighborhoods.

Bank One & JP Morgan Chase

With the support of the Bond Bank and LISC secured, the next task was to find an appropriate lending institution to join the syndicate. Identifying a lender interested in investing substantial private capital was critical. Here again, the city's relationships proved invaluable.

Leaders at the Bond Bank had worked successfully with Bank One on numerous occasions, and thought highly of the bank's understanding of municipal finance issues. On the strength of the Bond Bank's recommendation, AECF, the Bond Bank and the Charter Schools Office reached out to a local Vice President with Bank One's municipal finance team.

Bank One was immediately enthusiastic about the opportunity. Over the years, the bank's regional municipal-finance team had developed a healthy business providing capital to several of Indianapolis' largest public-works projects.

Bank One viewed the bank's participation in the proposed Charter Schools Facilities Fund not just in financial terms, but also as another way to demonstrate Bank One's commitment to the city of Indianapolis'—a commitment it took very seriously.

In 2003 alone, Bank One donated approximately $100 million to nonprofit organizations nationally and, with its partners at JP Morgan Chase, provided approximately $1 billion in community development lending. The opportunity was of special interest to Bank One at the time because it offered the potential to enhance the institution's Community Reinvestment Act (CRA) rating. At the time of the Facilities Fund effort, Bank One was in the midst of merger discussions with JP Morgan Chase—a deal that is now complete – and its standing with CRA regulators could have impacted the approval of the merger.

STRUCTURING THE DEAL

Based on a projected demand of 15-20 school construction projects over the next five years, Bank One agreed to extend a $20 million line of credit to the Indianapolis Bond Bank, while AECF and LISC both agreed to provide $1 million dollars in the form of loan guaranties to be drawn down only in the case of default. After borrowing from Bank One, the Bond Bank would loan money to qualified charter schools for the acquisition, construction, renovation, and leasehold improvement of their facilities. Participating schools would then make regular debt-service payments to the Bond Bank that would in turn be used to repay the line of credit to Bank One.

Under this scenario, AECF's funds would never actually be lent out to the schools for construction, or even leave the Foundation's coffers. Rather, the funds would remain with AECF and LISC and only be drawn down in the case of default. With AECF and LISC willing to shoulder the burden of any initial losses, the Bond Bank would not have to return to the City-County Council to make good on the moral-obligation pledge. LISC was also very comfortable with the idea of loan guaranties as it is had employed them successfully on previous occasions.

Anticipating that most loans would be used for school renovation rather than construction, the maximum loan size was capped at $750,000, with exceptions to be approved by an advisory review committee. Total borrowing costs to individual schools would range between approximately 3-6 percent of the loan size. Even if a school could access funds on the open market, these borrowing costs represented a substantial discount. Without a program like the Facilities Fund, charter schools could expect to pay interest rates of upwards of 10 percent if financed by traditional sources. Over the course of a 10-year mortgage, a school borrowing the maximum amount from the Fund stood to save up to $190,000.

In case of excess demand for the Facilities Fund, priority would be given to applications from schools in which at least 50 percent of the student body was eligible for the federal free or reduced-price meal program. As a rule, charter schools operated by for-profit educational-management organizations would not be eligible for the program.

Fund Management

In addition to its current role as authorizer, the Charter Schools Office would take primary responsibility for marketing the Facilities Fund and directing all inquiries to the Bond Bank. Should a participating school experience difficulty meeting its loan obligations, the Mayor's Charter Schools Office would work with the school to identify problem areas and develop a strategy for resolution.

The Bond Bank would establish a Charter School Loan Review Committee to review all loan applications that would in turn make recommendations to the Bond Bank's Board of Directors. Given its experience overseeing major public works projects, the Bond Bank would also monitor the school construction process and oversee the Fund's loan portfolio.

At the local level, Indianapolis LISC would provide technical assistance to support charter schools in the application process and provide loan underwriting services to the Bond Bank, including an analysis of risk posed by the proposed loan. At the national level, LISC's EFFC would retain a voting seat on the Loan Review Committee. This committee, comprised of representatives from the Bond Bank, the Mayor's Charter Schools Office, LISC's EFFC, Indianapolis LISC, and Bank One, would review all applications for the Facilities Fund.

AECF took a non-voting seat on the Loan Review Committee because, as a private foundation, AECF is not allowed to further direct the funds once the initial investment is made. The Foundation's role would be limited to monitoring its investment once the deal closed, including receiving regular reports from the Bond Bank and making an annual site visit. For AECF, regular reporting requirements were critical not only to ensure that its investment was meeting its intended programmatic and financial goals, but for other reasons as well. Because of the nature of AECF's guaranty provided on behalf of the Indianapolis Bond Bank, the Foundation was required to exercise expenditure responsibility over the PRI and provide information to the IRS on an annual basis regarding the guaranty. This helped assure the government that the funds were being used to further the Foundation's charitable purpose.

Risk Mitigation

Settling on the Fund's basic structure and management responsibilities had not been without its challenges, but it was relatively easy in comparison to other aspects of the deal. In particular, while everyone agreed that the Facilities Fund should provide affordable school construction loans to as many charter schools as possible, no one wanted to lose money in the process. All parties agreed that necessary precautions would need to be taken to minimize each partner's unique financial risks. Because the Facilities Fund included partners from the public, private, and nonprofit sectors, mitigating all parties' risks and keeping the cost of capital low was a balancing act requiring substantial creativity.

Bank One's needs were relatively straightforward. In addition to making a fair return on its investment, the bank needed to meet two conditions. First, the bank's line of credit needed to be senior debt, meaning that its debt must be repaid before any other creditors receive payment. Second, still somewhat uncomfortable with the credit risks charter schools posed, Bank One needed the city's moral obligation pledge in order to lend at favorable interest rates.

The Bond Bank understood that the city's moral obligation pledge was the key to the deal. Ironically, in order to offer this commitment, the Bond Bank needed to be certain that it would never be called upon to fulfill its pledge. Covering a cash shortfall would require seeking an appropriation from the Indianapolis City-County Council, a politically unattractive option.

Requiring borrowers to set aside one year's worth of debt repayment in a debt service reserve is an industry-wide standard practice, and the Fund was structured for participating schools to fund the debt reserve by borrowing the capital necessary as a part of the total loan amount. However, in exchange for the city's moral obligation pledge, the Bond Bank insisted on a second payment reserve. Funded by AECF and LISC's loan guarantees, this second reserve would function as a "first loss" pool. This meant that, in the event of default, AECF and LISC would be required to cover the first $2 million of losses.

At the end of the process, the Fund structure was modified slightly as the Bond Bank applied for and successfully received funds from the U.S. Department of Education (DOE) to fund the debt reserve. The U.S. DOE grant funded the entire debt reserve up-front, taking that burden off the individual school borrowers.

This element made the Facilities Fund even more affordable for participating schools, allowing them to use borrowed funds exclusively for project costs (i.e. site acquisition, construction, or renovation).

In order to secure the city's moral obligation, and the favorable interest rates that came with it, AECF and LISC agreed to assume full responsibility for the first $2 million in default losses. However, neither organization wanted to jeopardize their investment. Just as Bank One sought security by way of the city's moral obligation pledge, and the Bond Bank sought protection via a second payment-reserve fund, AECF and LISC wanted to carve out safeguards as well.

The Foundation's previous work designing the city's charter approval process and Charter School Performance Framework served as the first line of protection, shielding both ACEF and LISC from substantial risk. If these protections were not enough, both organizations saw an opportunity to seek additional protection via detailed Fund Management policies and the actual Guaranty Agreement. These outline every possible contingency as well as each party's specific responsibilities. Issues covered in the documents include everything from the exact credit approval criteria to how losses and other assets would be divided in the event of a default. Due to the limited role it would play after the deal closed, most of AECF's protection came by negotiating financial covenants and monitoring procedures into the document's final language.

By taking an active role in designing these documents, AECF and LISC prevented the possibility of risky loans being made, required appropriate monitoring and servicing, and diminished the chance that default might occur.

AECF's interests were also protected by Indianapolis LISC, which was incorporated into the Fund Management policies, by providing applicants with technical assistance. In addition to reviewing applications, LISC's local staff also agreed to present the Loan Review Committee with a written report summarizing the applicant's strengths and weaknesses based on various programmatic and financial indices, allowing it an additional opportunity to voice its concerns.

Finally, the city had already established itself as a highly capable authorizer and the partners were confident in Mayor Peterson's commitment to see the city's charters succeed. The accountability system through which the Mayor's office established expectations, monitored progress, reported to the public, and made informed decisions about the future of the schools had already been lauded nationally as a best practice. To AECF, the net benefit of the city's comprehensive and proactive accountability system was clear. Should a Mayor-sponsored charter school experience any difficulty—academically, financially, or otherwise—the system was specifically designed to detect and correct any issues well before default was likely to occur.

CONCLUSION

On April 18, 2005, the Indianapolis City-County Council passed the measure enabling the Indianapolis Bond Bank to administer the $20 million Fund by a near unanimous vote. With the Fund a reality, the Annie E. Casey Foundation and its Education Initiative team is looking ahead to additional opportunities to support the facility needs of charter schools in other states.

The Facilities Fund is just one example illustrating how PRIs can bridge the gap between the public, private, and nonprofit sectors to solve critical national problems in local communities. In this case, it is unlikely that a grant could have attracted the kind of multi-sector co-investment capital required to meet the needs of prospective charter schools in Indianapolis. Fortunately, the Foundation has access to a wide range of philanthropic tools—including social investments—that allow us to respond to the needs of a specific situation in whatever way is best suited to the local context.

The use of PRIs and other social investments enhances the Foundation's ability to affect change in neighborhoods. They present opportunities to leverage limited funds more effectively, build the capacity of organizations, complement grant making, and offer larger levels of financial support when it is needed. A foundation's financial influence, especially when combined with that of other institutions, also has the capacity to affect market behavior in ways that positively impact the communities in which it works. Most importantly, PRIs represent a powerful philanthropic tool that can substantially benefit communities for decades to come.

The Annie E. Casey Foundation, has always sought out innovative solutions to achieve our mission. The range of social investments available to us continues to grow, creating more opportunities for creative, flexible forms of financing for people and organizations working to strengthen families and improve outcomes in communities across the country.

ENDNOTES

[1] Hassel, Brian. "Fast Break in Indianapolis: A New Approach to Charter Schooling." *Progressive Policy Institute*, September 21, 2004.

[2] http://www.indygov.org/eGov/Mayor/Education/Charter/Accountability/2005 /home.htm.

[3] Case-writer interview with Bruno Manno, Spring 2005.

[4] Ewing Marion Kauffman Foundation. "Debunking the Real Estate Risk of Charter Schools" 2005.

[5] Brody, Weiser, Burns. "Current Practices in Program-Related Investing" October 2001.

[6] The major credit rating agencies in the U.S. are Standard & Poors, Moody's, and Fitch. While each agency uses a slightly different rating system, generally AAA is the highest credit quality rating while C or D is considered the lowest or junk grade rating. An introductory overview on credit rating can be found at http://www.investopedia.com/articles/03/102203.asp.

[7] Case-writer interview with Will Pritchard, Senior Program Officer, Indianapolis LISC. Spring 2005.

[8] Elise Balboni (personal communication) Spring 2006.

[9] Case-writer interview with Elise Balboni, Director of Educational Facilities Financing, LISC, and Barbara Page, Vice President of Education Programs, LISC, Fall 2005.

CONTACT INFORMATION

For more information, visit the Foundation's website at www.aecf.org

The Annie E. Casey Foundation
701 St. Paul Street
Baltimore, MD 21202
Phone: 410-547-6600
Fax: 410-547-6624
E-mail: si@aecf.org

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