STATE CAPITOL
P.O. BOX 942849
SACRAMENTO, CA 94249-0018
(916) 319-2018

DISTRICT OFFICE
ELIHU M. HARRIS STATE BUILDING
1515 CLAY STREET, SUITE 2204
OAKLAND, CA 94612
(510) 286-1670
FAX (510) 286-1888

E-MAIL
Assemblymember.MBonta@assembly.ca.gov

Assembly
California Legislature

MIA BONTA
ASSISTANT SPEAKER PRO TEMPORE
ASSEMBLYMEMBER, EIGHTEENTH DISTRICT

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May 2, 2022

RECEIVED
05/02/2022

The Honorable Rudy Salas
Joint Legislative Audit Committee
1020 N Street, Room 107
Sacramento, CA 95814

RE: Audit Request—CFSA's Charter School Facility Grant Program & Conduit Revenue Bond Program

Dear Chair Salas,

I am respectfully requesting that the Joint Legislative Audit Committee approve an audit of the state's Charter School Facility Grant Program (CSFGP) to determine whether program oversight is sufficient to prevent taxpayer dollars from financing private acquisition of school facilities, to determine the scope of such acquisition to date, and to determine the effectiveness of the program's goals to provide high quality school facilities to low-income charter school students.

Background

Charter schools in California leverage a number of state and federal programs to pay for their educational facilities. For some charters, their school site is provided by a local district for a nominal fee pursuant to Proposition 39. For others, it is constructed with general obligation bonds provided through the Charter School Facilities Program or with conduit revenue bonds. And still others leverage the Charter School Facility Grant Program to pay their school rent and lease costs.

The Charter School Facility Grant Program[1] was established in 2001 (SB 701, O'Connell, Chapter 892, Statues of 2001) to provide charter schools serving extremely low-income pupils (70% or more free or reduced-price meal eligible) with assistance for *facilities rent and lease costs* (emphasis added). The State Legislature funded this grant program with an initial on-going appropriation of $10 million to support charter schools that leased facilities from community centers, nonprofits, churches, storefronts, and the like.

The legislation creating the program has been amended several times since 2001. Subsequent bills moved the administration of the SB 740 program from the Department of Education (CDE) to the California School Finance Authority (CSFA) in the State Treasurer's Office and reduced the threshold to qualify for the program from charters serving—or geographically located in areas that serve—70 percent free or reduced-price meal (FRPM) eligible pupils to 55 percent FRPM eligible pupils.[2]

[1] EDC 47614.5
[2] See AB 948 (Olsen, 2014) and AB 104 (Assembly Budget Committee, 2015).

Funding is provided to program participants at a rate of the lessor of 75 percent of annual facilities rent and lease costs or approximately $1,117 per unit of Average Daily Attendance (ADA). Applicants to the program must be in good standing with their authorizer. Furthermore, the amount of a school's lease payments must be at, or below, fair market rent based on an independent appraisal. Program funds may also be used for costs associated with remodeling buildings, deferred maintenance, installing equipment, and improving sites, but only so long as all qualified applicants receive funds first requested for rent and lease costs. At time of writing, the CSFGP is oversubscribed.

Program regulations[3] explicitly prohibit SB 740 funds from paying a charter school's local match share for the Charter School Facilities Program, from paying costs associated with lease-to-purchase agreements, and from paying rent and lease costs associated with a facility previously purchased and paid in full by the charter school with State Charter School Facilities Incentive Grant Program funds.

Since 2009, well over half a billion Proposition 98 General Fund dollars have been disbursed to charter schools through the CSFGP. In the 2018-2019 program year, CSFA awarded $136.5 million to 418 charter schools through the CSFGP.[4] Undoubtedly, these funds have helped charter schools open and serve low-income students. However, these funds have also enabled large charter management organizations (CMOs) to acquire large amounts of real estate through property acquired via Limited Liability Companies solely owned and operated by a charter school's parent organization.

Evidence of Problem

Recent studies and analyses of available data have suggested that CSFGP program funds are used to finance the private acquisition of properties by related party Limited Liability Companies (LLCs).

A 2017 study published in the Indiana Law Journal describes how some charter school officials engage in "Enron-like related party transactions to defraud charter schools."[5] The study cited multiple examples at California CMOs including Imagine Schools and Ivy Academia. To leverage CSFGP funds for the related-party purchase of a facility, a CMO creates a nonprofit LLC. That LLC takes out a loan or receives a conduit revenue bond to purchase a facility. That LLC then leases the facility to the very charter school managed by the LLC's parent company. Over time, the LLC uses CSFGP funds to pay off its loan obligations, wholly owns the school facility, and continues to qualify for CSFGP program lease reimbursement funds so long as the applicant complies with program requirements.

The Assembly Education Committee analysis of AB 2484 (Bonta, 2022) noted that CSFGP funds are used to pay for buildings owned by related parties and listed a series of examples where CSFGP awards have broached or exceeded the purchase price of a given facility. CSFA's application for the CSFGP already requires that applicants disclose if their leased facility is owned by a related party.[6]

CSFGP funding and conduit revenue bonds have been allocated to charter schools that were financially mismanaged, failed to meet academic standards, or in violation of the law and subsequently closed.

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[3] See CCR Title 4, Division 15, Article 1.5.

[4] See CSFGP Awardee Lists. https://www.treasurer.ca.gov/csfa/csfgp/awardees.asp

[5] "Are Charter Schools the Second Coming of Enron?" An Examination of the Gatekeepers that Project Against Dangerous Related-Party Transactions in the Charter School Sectors." 93 Indiana Law Journal 1121. https://www.repository.law.indiana.edu/ilj/vol93/iss4/5/

[6] See attached CSFGP application.

According to an analysis of publicly available data from CDE and CSFA, from 2012-2021, $61.5 million were allocated to charter schools that subsequently closed. Additionally, nearly 20 percent of schools awarded CSFGP funds later closed. Already, an extraordinary audit conducted pursuant to AB 139 of Tri-Valley Learning Corporation (TVLC) revealed that TVLC created shell companies to gain access to taxpayer dollars and purchase private property. A summary of occupational fraud in the audit states:

> Through the establishment of a CMO, TVLC's CEO created shell companies to separate nonprofit public benefit corporations and/or for-profit limited liability companies to gain access to public taxpayer facility dollars and purchase property that was converted to private ownership. These purchases were made possible through two separate tax-exempt bond issuances including a Qualified School Construction Bond totaling more than $67 million in a three-year span.[7]

Publicly available financial reports from charter management organizations operating throughout California reveal that creating limited liability companies (LLCs) that are wholly owned subsidiaries of a management organization in order to hold real estate is a common practice.[8]

In October 2021, the *Daily Breeze* reported that Alliance Alice M. Baxter College-Ready High School closed after operating for just 7 years. Alliance purchased the building that the high school occupied in 2014 for $3.4 million. The school received over $1 million in CSFGP program funds and is now listed for sale with an asking price of $9.9 million.[9]

<u>Absent strategic planning, CSFGP funds and conduit bonds finance the acquisition of school facilities in areas without a need for additional classroom space.</u>

Before approving the construction of a new public-school facility with bond financing, the Office of Public School Construction determines whether additional classroom space is needed to accommodate the projected student population over the next five years. However, charter schools that purchase facilities through related party LLCs with CSFGP funding or through conduit revenue bonds need not determine if such additional space is justified based on projected student population growth. According to the report "Spending Blind," an estimated 450 charter schools have opened in places that already have enough classroom space for all students. Additionally, at least 30 percent of charter schools neither opened in areas with additional need for classrooms seats nor provided an education that was superior to that offered in nearby public schools.[10]

<u>The law does not require facilities acquired or constructed with CSFGP funds or conduit revenue bonds to conform with the same requirements as those acquired and constructed through the Charter School Facilities Program.</u>

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[7] AB 139 Extraordinary Audit of Tri-Valley Learning Corporation, 16. http://archive.acoe.org/documents/AB139-Extraordinary-Audit--Tri-Valley-Learning-Corporation.pdf

[8] See Alliance College-Ready Public Schools Consolidated Financial Report, June 30, 2020. https://4 files.edl.io/2d7b/08/04/21/185943-0eb14129-1dad-4b4c-adf8-768ff4bd6fc4.pdf

[9] "Charter School moves out of San Pedro, leaving historic building for sale." October 28, 2021. Daily Breeze. https://www.dailybreeze.com/2021/10/01/charter-school-moves-out-of-san-pedro-leaving-historic-building-for-sale/#:~:text=The%20Alliance%20Alice%20M.,and%20serve%20low%2Dincome%20students.

[10] "Spending Blind." In the Public Interest. April 2017. 5-6. https://www.inthepublicinterest.org/wp-content/uploads/FINAL_ITPI_SpendingBlind_April2017.pdf

Facilities acquired through the Charter School Facilities Program must comply with the following requirements (non-exhaustive list):

- constructing pursuant to the Field Act[11]
- capping allowable project costs
- considering equity metrics
- providing a 50 percent local match share[12]
- holding a restrictive deed[13]
- following an established process for use of a facility if it is no longer needed by the charter school[14]

However, those acquired with CSFGP funds or conduit revenue bond funds need not comply with any of the above requirements, circumventing the intent of the law for schools constructed and acquired with public funding.

If these studies and analyses are correct, legislative action may be warranted.

Audit Scope and Objectives

1. Review the administration of the CSFGP and conduit revenue bond programs to determine whether CSFA appropriately administers funding, with particular attention to conflict-of-interest laws outlined in Government Code 1090.
2. Determine the number and percent of CSFGP recipients that receive funding from the program based on their eligibility under EDC 47614.5 (c)(2)(A)—physical location by a charter school in an area of a public elementary school in which 55 percent or more of pupil enrollment is eligible for free or reduced-price meals.
3. Determine the criteria by which CSFA staff decides whether a CSFGP application should be approved or denied and evaluate whether these criteria meet state law and regulations. Furthermore, evaluate the consistency with which these criteria are applied and if these criteria are sufficient in meeting the intent of the law (e.g., funds should be used for lease reimbursement rather than property acquisition).
4. Determine the criteria by which CSFA staff determine whether a conduit revenue bond application should be approved or denied and evaluate whether these criteria meet state law and regulations. Furthermore, evaluate the consistency with which these criteria are applied and if these criteria are sufficient in meeting the intent of the law (e.g., the construction of school facilities according to appropriate labor laws and building codes for K-12 facilities).
5. To the extent possible, calculate the following:
    (a) The amount and percentage of CSFGP dollars that have been allocated to related parties;

[11] EDC 17280.
[12] See EDC 17078.57 and CCR 4 §10156.
[13] EDC 17078.62.
[14] EDC 17455-17484.

(b) The amount and percent of properties—and their estimated value—that have been acquired by LLCs wholly-owned by charter schools and charter management organizations since CSFGP's establishment;

(c) The amount and percent of properties acquired by LLCs with CSFGP funds in areas where the Office of Public School Construction has determined there is no need for additional classroom space;

(d) The amount and percent of CSFA conduit bond recipients that also receive CSFGP funds;

(e) The amount and percent of CSFGP fund recipients affiliated with charter management organizations or national charter chains;

(f) The amount and percent of applicants to the CSFGP that have been denied funding.

6. Determine which charter school(s) or charter management organization(s) has benefited the most from the CSFGP and from the conduit revenue bond program.
7. Determine how properties acquired by LLCs with CSFGP funds are used after the charter school occupying the facility has closed.
8. Evaluate the status of both the CSFGP and conduit revenue bond program—including the interaction between the two programs—and assess whether the programs contribute to waste in education spending or unethical, unlawful, or improper activities.
9. To the extent possible, determine how would the dissolution of the CSFGP could impact charter schools' ability to repay conduit revenue bonds issued by CSFA, and determine if there are broader implications for the state's credit rating if charter schools are unable to repay conduit revenue bonds issued by CSFA.
10. Review and assess any other issues that are significant to the audit.

I appreciate the Committee's time and attention to this matter, and I respectfully request that you approve an audit of CSFA's Charter School Facilities Grant Program and conduit revenue bond program. Please do not hesitate to contact Eliza Brooks in my office at (916) 319-2018 with any questions.

Sincerely,

[redacted] [redacted]

Mia Bonta
Assemblymember, 18th District

Patrick O'Donnell
Assemblymember, 70th District

<u>Attachments</u>

(1) Assembly Education Committee analysis of AB 2484
(2) CSFGP application by Thrive Public (2019-20)