Funding Growth, Expanding Opportunity

NOVEL FUNDING MECHANISMS FOR SCHOOLS OF CHOICE

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Executive Summary

What does the future hold for private school choice programs? The recent past has seen tremendous growth in the number of states creating voucher, tuition tax credit, and Education Savings Account programs. More and more students are using state support to help defray the cost of a private education.

But these programs are starting to run into a constraint: space. If we want choice programs to truly transform the educational landscape across the country, they have to be able to spur high-quality schools to scale up and create new seats for students, and they have to be able to spark the creation of new high-quality schools. The current funding arrangement for these programs prevents that, as they generally fund at or barely over the marginal cost of adding an additional student to an already efficient private school.

In this paper, I look at the myriad funding mechanisms for private, charter, and traditional public schools and try to apply lessons from each of these sectors to private school choice programs. From bond financing to venture capital investments, private school choice programs and the institutions and organizations that support them could do a much better job deferring the capital, infrastructure, and other fixed costs of participating private schools.

Some recommendations include:

1. Decreasing start-up costs through incubators and "tiny schools";

2. Helping schools access bonds and other low-cost financing through moral obligation pledges, sovereign school funds, and credit support;

3. Getting the private sector involved productively through B-Corps and low-profit limited liability companies; and

4. Fostering partnerships with support institutions and venture capital sources.

The traditional public and charter school sectors have figured out how to build buildings and start new schools. It is time for the private sector—and particularly private schools with students financed by school choice programs—to catch up.

Funding Growth, Expanding Opportunity: Novel Funding Mechanisms for Schools of Choice

Michael Q. McShane

Money. In *Cabaret*, it makes the world go 'round. According to Pink Floyd, it is a gas. It, specifically of the cash variety, ruled everything around the Wu-Tang Clan.

For all of the lofty talk about instruction and school design in K–12 education, at the end of the day, it all comes down to money. Schools have both current operational costs, such as teacher and administrator salaries, and fixed capital costs, such as the buildings and the computers and desks inside them. To make education happen, educators need access to money for both. If schools can only access the latter, they will have schools without students. If they can only access the former, they will have students but no schools.

This helps to explain one of the more vexing issues in the school choice community: namely, the different trajectories of charter schooling and private school choice programs. Figure 1 shows a comparison in enrollment in the two sectors since the year 2000.

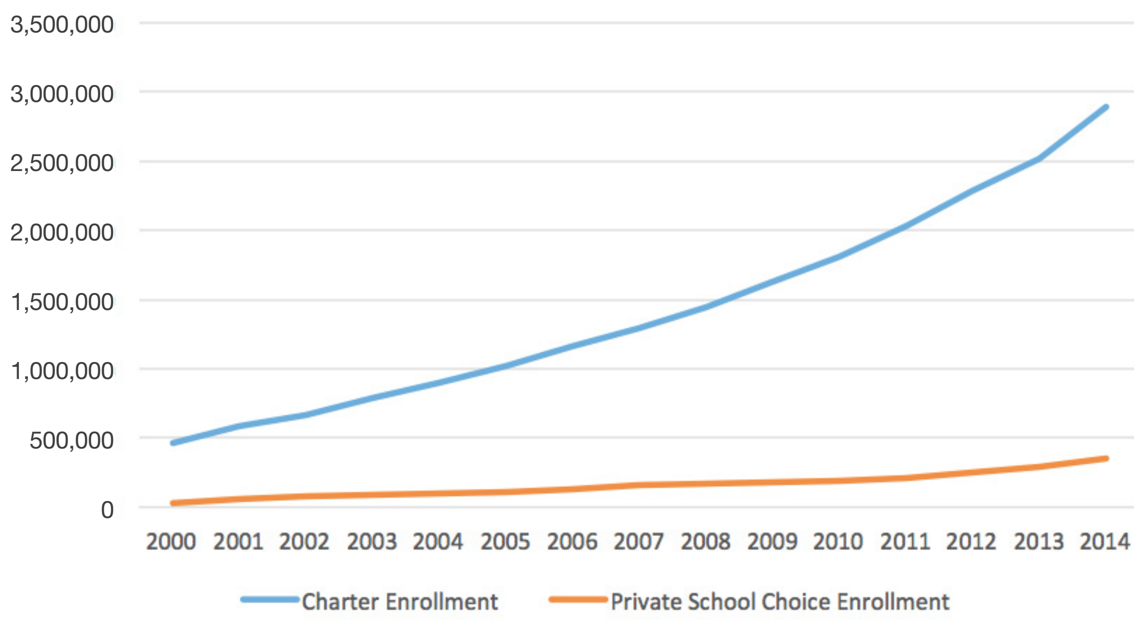
Both of these programs (at least the modern version of vouchers) started at approximately the same time, but one has grown to have almost 10 times the enrollment as the other. This is particularly stark because charter schools had to be created with no foundation. More than 6,500 charter schools exist now that did not exist 25 years ago.

Now, charter schools have obviously had many advantages that private school choice has not, most notably broader and deeper political support. Many more students attend charter schools because more students are *allowed to choose* charter schools. But, it is also true that more and more students, particularly in states such as Florida, Indiana, Louisiana, Wisconsin, and now Nevada, have the ability to choose private schools.

As private school choice supporters break through the political logjam that has stifled the growth of their sector, they are quickly running into another problem—space. Quality seats in existing private schools are limited. Case in point: in 2014, the Friedman Foundation released a study of Indiana private schools that found about 41,000 private school seats available to voucher students across the state.[1] In the 2015–16 school year, more than 30,000 students will participate in the program and, if trends continue, will overwhelm the supply of private school seats in the very near future. Unless new schools can open, the sector risks quickly hitting a point of saturation with no possibility of market expansion. School choice will be nice for the handful of kids that fill empty seats, but it will not drive change anywhere near to the effect that its proponents hoped. Put plainly, if supporters hope to see private school enrollment numbers reach the level of charter school enrollment numbers, they are going to have to get serious about covering the fixed costs of buildings, desks, computers, and so forth.

In this paper, I hope to accomplish three things. First, I would like to make the case that the current funding levels and methods private school choice programs use are insufficient to cover the capital costs necessary for schools of choice to grow, scale, and serve more students. Second, I would like to sketch out the many ways in which schools—traditional public, charter, and private—are currently funded to help widen the perspective of school financing options. Finally,

Figure 1. Number of Students Enrolled in Charter Schools versus Private School Choice Programs, 2000–Present



Sources: Private school data from American Federation for Children's *2015 School Choice Yearbook*. Charter school data from the National Alliance for Public Charter Schools' data dashboard.

learning from these other funding programs, I would like to offer concrete options to help lower or defray start-up costs for schools of choice.

Today's Funding Landscape

Private school choice programs vary widely in the amount of scholarship money students are eligible to receive from the state. According to the Friedman Foundation for Educational Choice, the Arizona Individual Income Tax Credit Scholarship Program, in which 25,000 students currently participate, has an average scholarship value of $1,927. At the other end of the spectrum, the average DC Opportunity Scholarship was valued at $8,712.[2]

Is this enough money? It depends on what the goal of the program is. If private school choice programs are simply seen as a way to get students who otherwise could not afford tuition into an existing private school, funding the marginal cost of adding that student would be sufficient. For an efficiently operated school that has a few empty desks in the back of the classroom, four or five thousand dollars might be adequate. If, however, the goal is to use school choice programs to grow the stock of high-quality seats for students by either encouraging schools to scale and grow or to spur the creation of new schools, current funding systems will simply be insufficient.

Let's look at some of the costs associated with growth. While the cost to build a new school building is extremely context dependent, some enterprising researchers and journalists have compiled averages across states and regions. One 2014 report found that the median cost in New England was $306.34 per square foot for an elementary school, $213.33 per square foot for a middle school, and $303.03 per square foot for a high school.[3] According to the 35th annual Education Construction Report, across the country the cost is lower at the median, with an elementary school costing $154 per square foot, a middle school costing $167 per square foot, and a high school costing $154

Table 1. School Funding Sources for Capital and Start-Up Costs

	Traditional Public	Charter	Private
Bond Financing	*Large Investment* $3–4 billion per year (estimate)	*Moderate Investment* 730 total bonds valued at $9 billion from 1998 to 2014	*Little Investment* Less than 200 total bonds (estimate)
Venture Capital	*Little Investment* Almost no investments are made for whole school models, though some are made for tools for use in schools.	*Moderate Investment* Several prominent sources, including the Charter School Growth Fund, New Schools Venture Fund, and The Charter School Fund	*Little Investment* Mostly for high-end disruptive models around the world; Burgeoning efforts (The Drexel Fund)
Philanthropic Investment	*Large Investment* A lot is invested, but it is hard to say how much is for capital costs particularly.	*Large Investment* $2.1 billion in direct support of facilities funding	*Large Investment* Support from religious groups; Foundation support (limited); Institutional support (limited)
Direct Government Support	*Large Investment* Dedicated funding streams just under $1,000 per student per year (varies by state)	*Moderate Investment* Federal funds and some state programs	*Little Investment* Voucher, tax credit, and ESA funding does not cover capital costs

Source: Author's calculations.

per square foot. That means that the median elementary school that has 600 pupils and is 73,590 square feet costs right around $11.3 million to build. The average middle school, which is larger, costs around $16.9 million, and the average high school around $37 million.[4]

Of course, public schools do not have to pay this all at once. As discussed later in this paper, they have a variety of mechanisms to spread the cost out over an extended period of time. Most private schools do not do this and instead rely on capital campaigns to generate the money for their capital costs.

Understanding the existing stock of school buildings is a challenge as well. We can count how many students are currently enrolled in schools, and we can even ask schools if they have extra space, but it is tough to tell what conditions school buildings are in and what, if any, costs will be associated with those buildings moving forward. From our research, it looks as though Kansas is the only state that systematically tracks the age of private school buildings. For a variety of reasons, Kansas might not be representative of the nation as a whole, but it is the best data source we have on private schools' ages. According to the Kansas Department of Education, the average private school building is 53 years old.[5] If national averages are anywhere close to that, this is a serious problem. Because school buildings need expensive updates as they age, many of the seats that we currently count as available to students will not be in usable shape in 10 or 15 years.

Building age is not the only reason that capital costs are high for private schools. Wiring schools for computers, integrating tablets and interactive whiteboards, and ramping up Internet service are serious expenses as well. A school receiving less than $5,000 per student per year will not be able to afford these expenses.

To be fair, it is not just private school choice programs that struggle. In 2014, a group of researchers from the University of Arkansas published a report on charter school funding and found that, on average, charter schools received 28.4 percent less funding than traditional public schools, a real dollar difference of $3,814 per student. This average, however, does mask the fact that some states do help charter schools with facilities funding, as discussed in the next section. In fact, the researchers found that 14 states have some avenue that charter schools can use to help defray their capital costs.[6] The federal government also spends around $250 million on charter schools, of which around $11 million goes toward Facilities Incentive Grants and another $12 million toward credit enhancement for charters.[7] Myriad programs, described in the next section, in states across the country help charter schools and traditional public schools defray some of these big-ticket costs. Advocates for private schools can learn from them.

Perhaps the clearest way to compare and contrast the various funding mechanisms available to schools is to create a matrix that puts the school type on one axis and the funding source on the other (table 1).

Bond Financing

Bonds are regularly issued by school districts to fund capital projects. A bond is a very simple financial instrument in which an investor loans his or her money to the school district, city, state, or any other bond-issuing organization and that organization then promises to pay back the bond plus interest. Investors like bonds because they are extremely low risk. School districts like bonds because they have to pay less interest than if they got a loan for the same amount of money from the bank. Private and nonprofit organizations—and school districts as well—specifically like tax-free bonds, as they end up reducing the interest rate by 1 to 2.5 percent.[8]

Public school districts use bonds quite frequently to pay for capital projects. Because of the diffuse and local nature of such issuances, it can be hard to get a handle on the total number of school bonds in a given year; but according to the *New York Times*, nearly $4 billion in bonds were issued in 2011, and at the height of the credit boom in 2006, $9 billion in bonds were issued.[9] Bonds are usually successful at the ballot box. In California in 2014, for example, 81.5 percent of the bond measures (128 total) passed.[10] States are also able to sweeten the pot by offering matching funds for local bond issuances from statewide bonds.

Charter schools use bond financing as well. According to a 2014 report by the Local Initiatives Support Corporation (LISC), between 1998 and 2014, 730 bonds totaling $9 billion in financing have been issued to support charter schools.[11] But, as LISC points out, the vast majority of these bonds receive low rating from credit agencies (either BBB–, BBB+, or BBB), which results in higher interest payments.

If the goal is to use school choice programs to grow the stock of high-quality seats for students by either encouraging schools to scale and grow or to spur the creation of new schools, current funding systems will simply be insufficient.

Private schools have used bond financing extremely infrequently. According to a 2006 report commissioned by the National Association of Independent Schools, at that time only 70 private schools had issued bonds with published credit ratings.[12] Assuming that the rated/unrated breakdown is the same between charter and private schools (about 40 percent of charter bonds are not rated) and updating that figure to the present, it is fair to estimate that fewer than 200 private schools have used bonds to finance capital expenses.

But bond financing can be incredibly helpful for private schools. In 2012, the Catholic Educational Capital Corporation accessed $9 million from the Colorado Educational and Cultural Facilities Authority (CECFA) and offered it to Iona Prep, an all-boys high school operated by the Christian Brothers in New Rochelle, New York, to purchase an elementary school. CECFA is a body with the ability to provide tax-exempt bond financing for a variety of educational and cultural nonprofit organizations, both inside and outside of Colorado, that has offered more than $5.5 billion in bonds. According to the National Catholic Register, over the lifetime of the bonds Iona Prep is expected to pay 2.09 percent in interest, instead of a standard rate of more than 5 percent. This favorable rate stands to save the school $1.8 million.[13]

Venture Capital

Venture financing has become a kind of catch-all term for early-stage investment in potentially transformative organizations. Technically, venture capitalists invest money early in exchange for equity in a company, hoping that the growth of the company creates greater value and thus a higher price for their slice of the pie. When the company is sold or goes public, the investors get their money. Venture capital solves a straightforward problem: many small enterprises are too risky for banks to lend them money. If they want to start an office or hire staff, they need start-up capital, and rather than pay interest on a loan for the access to that capital, they pay in shares of their company.

A substantial amount of venture financing exists in education in general, with more than $600 million invested across the education industry.[14] However, much less is specifically designated for helping new schools start and grow. This has a simple explanation: it has been extremely difficult for companies to make money operating schools. There have been numerous financial success stories in *selling* products to schools, but companies that have tried to provide a traditional education soup to nuts (such as Edison Learning and K12) have struggled to turn a profit consistently.

Philanthropic organizations have put their own twist on venture financing in the area of new school creation as a quick start before public dollars roll in. Rather than trying to get early-stage equity, they help schools get off the ground, hire staff, secure a building, and complete all of the other necessary start-up steps with the goal that as per-pupil funding dollars start to come in from the state, the operating costs will be covered. It is a "Moneyball" strategy for philanthropists. Rather than fully support an organization for its entire life, they can get it up and running, give the school the ability to tap into public sources for dollars, then move on and start again.

Charter schools have received a huge amount of venture financing. As detailed in the following section, they have seen more than $2 billion in grants, loans, guarantees, and other start-up cost support from high-profile organizations such as the New Schools Venture Fund and the Charter Schools Growth Fund.

But outside of financing, charter schools have also seen the emergence of another aspect of the venture-funding ecosystem to help them start, most notably incubators. One such incubator is 4.0 Schools in New Orleans. Founded in 2010, 4.0 has helped launch almost 40 new education ventures, including 3 new schools, by helping guide prospective entrepreneurs through the start-up process. Their assistance ranges from "beer storming" evenings where individuals can come to a bar and talk about their ideas, to a three-day boot camp–style strategy session, to a launch program that actually brings a proposed venture to life.

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In general private schools have seen limited venture financing, though that appears to be changing. Because private schools in the vast majority of instances will never be able to access public dollars, venture finance is not in a great position to solve some ongoing needs. Private schools have generally looked to more traditional avenues of philanthropic support when they have needed a new building or wanted to start fresh.

Two recent developments, though, are shifting the landscape. First, in the summer of 2014, Rob Birdsell, former CEO of the Cristo Rey network of Catholic schools, launched the Drexel Fund, a venture funding organization for private and particularly faith-based schools. Second, in the spring of 2015, AltSchool, a private schooling model built around personalized learning, raised $100 million in venture capital financing.[15] In both cases, it looks like venture financing is starting to get a foothold in the private education space.

Traditional public schools do not have a great deal of need for venture financing, based on the nature of school funding streams. When a district wants to build a new school, it can issue bonds, levy new taxes, or tap into state or federal resources.

Philanthropic Support

The go-to researcher on philanthropic support of public schools is Michigan State University Professor Sarah Reckhow. In numerous studies and her seminal book *Follow the Money: How Foundation Dollars Change Public School Politics*, she has categorized both how much philanthropic support has gone to public schools and how that support has been structured. It is hard to get a grasp on the amount of philanthropic support that has gone to schools, as schools use a variety of fundraisers to solicit outside dollars. The best estimate is that around $1 billion is spent per year by outside sources to support K–12 public education. While that seems like a lot, the overall spending of the system is more than $600 billion.[16]

In her book, Reckhow also notes that some of the bigger players in education philanthropy have shifted their focus from giving direct support to attempting to influence policy. On one level, this makes a great deal of sense. Trying to change schools with 1/600th of their current funding is probably not going to make much of an impact—it is better to use that money to redirect the vast majority of funds into efforts that promote your policy goals. For our purposes, it is clear that much of the outside philanthropy efforts that we witness with respect to traditional public schools is not being used to help defray capital costs of traditional public schools. Those costs are generally covered by the government.

Charter schools, on the other hand, have seen a large amount of both general philanthropic support and philanthropic support focused on defraying the costs of facilities. According to LISC, 29 nonprofit organizations currently provide grants, loans, guarantees, and other assistance to charter schools. Collectively, these organizations have given $2.1 billion in direct support to charter schools.[17] This too makes sense, as charter schools have struggled to access public dollars for facilities but do have access to public dollars for operation. Philanthropy can help to fill the gap.

Private schools, by necessity, have been large recipients of philanthropic support. Such support falls into two general buckets: annual support, or fundraising to close the gap between what it costs to educate a child at the school and what the school charges in tuition, and capital campaigns. It is next to impossible to tabulate the amount of support that private schools have received from religious organizations and individual supporters over time. It is also tough to get reliable data at the national level on this, but it is possible to get an understanding of the different ways that private schools access funding for capital projects and the strengths and weaknesses associated with each method.

Capital Campaigns. According to the National Association of Independent Schools (NAIS), which generally represents more affluent schools than the many private and parochial schools around the country, a well-run fundraising program for a private school should cost between 10 and 18 percent of the total amount raised.[18] NAIS cites the Better Business Bureau as saying that for any nonprofit, the cost of fundraising should not exceed 35 percent of the total amount raised, but that new or inexperienced fundraisers at schools should not be surprised if it costs 20–30 percent of the total amount raised.[19] In the best-case scenario, this means that a million dollar building project might cost an additional $100,000 to fundraise. For schools just trying to scrape by, this is an enormous budget line item.

Capital campaigns also rely on a donor base. Robert Pierpont at Indiana University's Lilly Family School of Philanthropy argues that 90 percent or more of the total amount raised for a capital campaign should come from 10 percent or fewer of the total number of gifts. To make that work, the campaign needs, at minimum, one gift of at least 10 percent of the total amount and two gifts of 5 percent of the total amount. Pierpont states that the "lead gift" should be at least 10 percent, the next 10 to 15 gifts should make up the 40 to 60 percent of the total amount, the next 100 to 150 gifts should make up the next 33 to 50 percent, and all other gifts should be the last 10 to 20 percent.[20]

In practice, this means that successful capital campaigns need access to a small number of big-money donors. Finding these high-level donors is difficult, though, and schools that are unable to tap into these sources are much less likely to be able to stage successful campaigns. According to nationwide statistics, 10.1 million households have $1 million or more in assets, 1.3 million households are worth at least $5 million, and 142,000 households are worth $25 million or more, excluding the value of primary residences.[21] These numbers far exceed the total number of schools in America, let alone those that need to conduct capital campaigns. But matching prospective donors to schools is costly and uncertain, meaning that capital campaigns have serious limitations in helping schools that need them most.

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Tithing. The concept of tithing, or the act of giving a percentage of one's income to the church, is as old as the Old Testament. In the book of Leviticus, the Israelites are commanded to give up "the tenth animal that passes under the Shepard's rod" to support the priestly class of Levites.[22] Today, the concept has translated to $8.5 billion given to Catholic parishes every year, $7 billion to Mormon Temples every year, and a total of roughly $50 billion in Christian tithing per year.[23] It is true that these dollars go to support all aspects of these organizations and not just schools, but they give us a general idea of the total amount of money out there.

Unfortunately for schools, tithing is in flux. A 2011 report found that tithing in Lutheran, Presbyterian, and Episcopalian churches as a percentage of income was at its lowest level in 41 years.[24] At the same time, a 2012 study of Catholic giving reported that it is up 23 percent from 2000 to 2010.[25] What is more certain than the exact amount of tithing in recent years is the general decline in religiosity in the United States. From 2007 to 2014, the percentage of adults who identified with any particular religion in the United States dropped by nearly 8 percentage points, and millennials are growing less religiously affiliated as they age. Today, 34 percent of millennials do not affiliate with a religion.[26] If these trends continue, the pool of potential tithers is only bound to shrink. Thus, more and more fundraising will be necessary to simply keep schools running, let alone fund capital projects.

It is also important to note that not all tithing goes to paying for schools, let alone specifically for school buildings. A lot more forks are digging into a shrinking pie. It is also possible that fewer, higher-wealth donors could make up for a smaller tithing base. In either case, though, the landscape for large-scale fundraising for church-affiliated schools is looking bleaker.

Foundation Support. Several foundations provide support for private schools, though again, not all of these dollars are specifically earmarked for capital projects. In the Walton Family Foundation's grant report from 2014, they list more than $2.3 million in support for private schools.[27] Given the scale of the number of schools and the amount of need, it appears that foundation support is nowhere close to the scale necessary to grow the supply of quality private school seats.

Institutional Support. Several religious institutions have also partnered with religious schools to help defray the start-up costs of new schools. The Notre Dame ACE Academies are a great example of this. Starting in 2010 in Tucson, Arizona, the University of Notre Dame has partnered with a set of Catholic schools around the country to boost their performance and grow the number of students that they can serve. Notre Dame was in a unique position to help, not only as the flagship Catholic university in the country, but also as the home of the Alliance for Catholic Education program, a teacher- and leader-preparation institution that has prepared more than 1,200 Catholic school teachers and 230 principals since 1993. The university was also able to tap into both their financial and human capital to help guide schools through the initial planning stages and develop a plan that would set them on a trajectory to improve and expand. The schools have now expanded to Florida, strategically locating themselves in states that have private school choice programs, to help defray the operational costs of the schools.

Government Support

Every state government provides direct funding for traditional school facilities. According to the US Census Bureau's report *Public Education Finances: 2013*, traditional public schools spent $47 billion in capital expenses in the 2013 school year, representing 7.9

percent of all public school expenditures. On top of that, the Census Bureau also identified $48.8 billion in current expenses under the category "operation and maintenance of plant."[28] While some of this funding overlaps with the bond issuances described above, these numbers give an overall magnitude to the amount spent per year on facilities for traditional public schools—approximately $1,000 per student per year.

Numerous state-level programs exist for charter school facilities as well. LISC identifies eight types of programs that states are using to help provide facilities for charter schools:

1. *Making district facilities available to charter schools.* Currently 11 states allow for this, which requires districts to provide space for charter schools, publish a list of unused facilities for charter schools to access, or offer the right of first refusal to charter schools to lease or purchase district buildings.
2. *Funding a per-pupil stream for facilities.* Currently 13 states allow for this, but 6 of those fund less than $250 per student.
3. *Offering capital grants.* Currently 11 states offer this.
4. *Allowing charter schools to tap into local taxing authority*. Four states offer this.
5. *Publicly funding loan programs*. Ten states offer this.
6. *Offering credit enhancement.* Nine states offer this.
7. *Offering tax-exempt debt through conduit issuers*. Currently 36 states offer this.
8. *Allowing charter schools to participate in Qualified School Construction Bonds program and Quality Zone Academy Bonds program.* Currently 35 states allow for this.

The federal government has taken several steps to help charter schools. According to LISC, seven federal programs within three departments help charter schools fund facilities:

- The Credit Enhancement for Charter Schools Facilities Program (Department of Education) has provided $268 million in credit enhancement to 24 organizations, which have used that to raise $3.2 billion on behalf of 466 charter schools.
- The State Charter School Facilities Incentive Grants Program (Department of Education) has awarded $141 million to five different states.
- The Community Development Financial Institutions Bond Guarantee Program (Treasury Department) gave $325 million in 2013 to four community-development organizations, three of which help provide facilities funding for charter schools.
- The New Markets Tax Credit Program (Treasury Department) provided $1.7 billion in tax credits for investment in charter schools.
- The Qualified School Construction Bonds program (Treasury Department) has been used to help charter schools in 11 states, but LISC did not have total spending figures.
- The Quality Zone Academy Bonds program (Treasury Department) has been used to help charter schools in 10 states, but LISC did not have total spending figures.
- The Community Facilities Program (Department of Agriculture) has provided more than $500 million in grants, loans, and loan guarantees for rural charter schools' facilities. [29]

Private schools have no such support. To date, no voucher, tax credit, or education savings account program provides specific funding for capital costs, and given the funding level of such programs, it is hard to see how a school would be able to do anything other than defray the marginal cost of adding the student with that voucher. The tax-exempt status that states grant private schools saves them some money, but other than that, they are on their own.

One reason for this is Blaine Amendments. Thirty-eight states have these amendments in their state constitutions, which bar public dollars from aiding religious-affiliated educational organizations. Blaine Amendments have a long and lurid history and were born out of virulent anti-Catholic bigotry, but they still affect policy across the country today.[30] Generally speaking, programs available to nonprofit organizations, such as bond financing, that are offered on a religion-neutral basis—that is, when any organization, religious or not, has equal access to the funding—have been found to not violate Blaine Amendments. However, specific wording and interpretation have made predicting a court's ruling difficult.

Solutions

Given all this, what can private schools learn about accessing novel financing mechanisms for their capital costs? A great deal. Solutions fall generally into four buckets. The first is simply decreasing start-up costs to reduce the fundraising burden. The second involves accessing credit support and bond financing to help lower the cost of borrowing. The third is getting the private sector involved in ways that can help attract some of this needed capital, and the fourth relies on developing strategic partnerships to spread expertise and fundraising ability across multiple organizations.

Decrease Start-Up Costs. It is tempting to start any discussion about improving new school operators with calls for the government to fund them in new and better ways. Rest assured; I will give plenty of examples of innovative financing models that use the government to provide more help. But before I get there, I should first establish that today it is far too expensive to start a new school. It is not just about the cost—it is also incredibly risky. High upfront costs coupled with the venture's uncertain nature create a cycle of increasing borrowing costs and eroding public support for government's involvement in financing schools of choice.

If schools must build or secure a lease on a large building; outfit that building with all of the necessary desks, computers, and file cabinets; hire 15–20 staff members; contract with food and janitorial services; and recruit the necessary number of students to secure the funding to actually operate the place before a single child walks through the door, it should come as no surprise that we do not see schools popping up on every street corner. It is a big deal to open a school. There is no guarantee that the school is going to work out. All of those students, and the dollars that come with them, could leave if they do not like what they are being offered. This inserts a huge amount of risk into the process, which creditors try to avoid. So how can we make it less expensive and less risky to open a new school?

Today it is far too expensive to start a new school. It is not just about the cost—it is also incredibly risky.

Incubation. Matt Candler, founder of 4.0 schools, likes to use a funnel analogy when he talks about incubating new ventures. He starts by making a very large number of small bets, say, buying a beer for a potential entrepreneur to hear a first pitch of his or her big idea. For the most promising of the beer pitches, he invests a little more money and brings the entrepreneur in for a few days to workshop his or her ideas with more knowledgeable people. For the best of those workshops, he provides seed funding and works with the entrepreneur to get more ideas. From hundreds of little bets, a small number of really promising bets emerges.

Private school incubators could work in a similar way. By slowly ratcheting up the amount spent, resources can be best targeted toward schools with the highest probability of success. Less money is wasted this way, lowering the overall cost for educators trying to create or expand private schools.

Tiny Schools. Another 4.0 Schools innovation worth digging into are "tiny schools." Rather than trying to start a whole school with its own building, staff, and several grades of students, 4.0 has worked with potential school leaders to try starting very small. A potential school leader could start with a pop-up school in an existing school's library for a small number of students on a Saturday morning. This could go on for a couple weeks while the school leader works out the kinks in whatever new thing he or she is trying to do, and it could give students a chance to check out the school without committing to a full year. If the pop-up is successful, that school leader could work with a whole group of students as a "school within a school" for a year. After time for refinement and now having a core group of students, the school could expand.

Tiny schools will work best in networks of schools that are looking to grow. Catholic dioceses, Lutheran synods, or collections of other schools united by a common religion are a logical first place to start. At first, the school would only need to offer a free space, such as a library or cafeteria. It would give the school a chance to see if this educator and his or her proposed school is worth investing in and pursuing.

Help Private Schools Access Credit Support and Bond Financing. Decreasing the start-up costs will not eliminate them entirely. Schools will still have to find a way to access capital. Given the struggles of capital campaigns, particularly for schools hoping to serve low-income areas, accessing public financing is essential. Obviously, the easiest way to crack this nut is to encourage states to include capital funding in the voucher or tax-credit programs that they administer or to increase the voucher amount so that money could be put toward capital costs. For a variety of political reasons, this is likely too high a price for states, but perhaps that will change. States could also make it easier for schools to access bond financing and could particularly work with schools in school choice programs to get low-cost financing of their debt. Until then, states can develop strategies that require small state investments to defray capital costs.

Moral Obligation Pledges. As LISC points out, both Colorado and Utah have taken steps to decrease the borrowing costs of charter schools. They allow qualifying charter schools to use the state's moral obligation pledge when working with creditors, an assurance that the state will pay off the school's debt should it default. This has drastically increased the investment grading of schools' bonds. Participating schools are not totally off the hook, as those that participate do have to set aside some of the money that they save into a pooled reserve fund to pay part of the cost of any defaults.

More states can create programs like these and can allow qualifying private schools that receive public funds through voucher or tax-credit programs to have access to the moral obligation pledge as well, provided that they contribute some of their savings into the default pool. This is a win for everyone and does not require states to pay anything unless schools default.

Sovereign School Funds. In 1854, the State of Texas was paid $2 million by the federal government for land that now makes up parts of Colorado, New Mexico, and Oklahoma. Rather than spend this money on some shiny new cannons, they saved it in a dedicated fund to help finance the state's public school system. Today, the Permanent School Fund, which has been supplemented by mineral royalties and the sale and lease of state lands, is worth $36.3 billion. Beginning in 2014, charter schools in Texas gained access to the Permanent School Fund, which, according to LISC, resulted in Triple-A bond ratings for borrowers.

Several other states, such as Alabama, Louisiana, and Oregon, have similar school funds. Allowing schools of choice to access those funds as credit backstops could be very helpful in lowering borrowing costs. Other states could think about moving the revenue from the sale of public lands or royalties from natural resources into sovereign wealth funds that could be used to ensure that creditors would not be left holding the bag. Similarly to moral obligation pledges, this does not require states to pay anything unless schools default.

Get the Private Sector Involved, Productively. Allowing for-profit operators is, in many places, a third rail in the discussion of school improvement. Past experiences with floundering or unscrupulous actors have poisoned the well in many communities. That is fair enough. But closing out for-profit actors removes a sector of potential operators that are very good at one thing—acquiring start-up capital. Perhaps allowing for-profit firms to operate schools in a limited capacity will be able to create the best of both worlds.

AltSchool is structured as a benefits corporation or "B-Corp," a designation that tells investors that the organization has a dual bottom line and is attempting to not only maximize profitability for shareholders but also advance a social mission. Corporate officers are held accountable for their progress toward both. B-Corps are a way for socially oriented ventures to have leeway from investors' financial expectations and spend time and resources advancing their social mission. They are almost a step between a nonprofit and a full for-profit venture, and in some ways, they can have the best of both worlds. AltSchool was able to attract a huge amount of investment while still pursuing its social mission. Those socially minded investors can get more bang for their buck, as some or all of the money they invest can be returned if the organization is successful. AltSchool can then invest this return into other ventures. This approach stretches existing philanthropic dollars.

Low-profit limited liability companies (L3Cs) function similarly to B-Corps, and philanthropies can count their contributions to them as part of their required yearly spend-down, even though that investment can eventually be returned to them. For a financing community that has limited resources, the ability to turn around investments and spread dollars wider is an incredible opportunity for supporting schools.

B-Corp designations are allowed in 28 states, while L3Cs are only allowed in 10. More states could pass laws to allow for these types of organizations, more could be formed, and more could be funded by civic-minded investors. These organizations could then operate schools so long as they continued to meet their dual bottom line, not only trying to make money but also working to do good. They could also work as a property holding company, purchasing buildings and keeping them up and then charging rent to schools of choice. This would move the capital costs of buildings from the fixed costs that school choice programs do not cover to the marginal costs that they do. It could make those capital expenses much more manageable.

Strategic Partnerships. Given the limited capacity to raise funds internally, private schools will need to look to strategic partnerships with outside organizations to help lower or cover the start-up costs of new schools.

Institutional Partnerships. Notre Dame's ACE Academies give a great blueprint for strategic partnership between a university and a network of private schools. Notre Dame has a steady supply of teachers and leaders, a huge amount of accumulated knowledge on successfully running Catholic schools, a large and enthusiastic donor base, and a known and well-respected brand. This made partnership with a diocese easier—not easy, but *easier*—and provided an opportunity for the university to intervene in a capacity that had an exit strategy. Rather than trying to completely take over schools and operate them from South Bend, Indiana, the ACE academies help with start-up and early operation in the hopes that the operational decisions can be designated to local actors.

Closing out for-profit actors removes a sector of potential operators that are very good at one thing—acquiring start-up capital.

Many other religious universities could develop such strategic partnerships with affiliated K–12 schools. These universities could house incubators for new schools where faculty would help prospective school leaders prepare their plan and then turn the operational decisions of the school back over to the community.

Private School Venture Financing. Private schools can learn a lot from the venture financing practices of charter schooling. In places where public dollars are available, philanthropic support can be stretched much further, as it is only needed for that first jolt to help get the school established, after which public sources can cover the school's operational expenses. Strategic grants and support from organizations such as the New Schools Venture Fund have been able to push an enormous amount of change for the amount spent.

The Drexel Fund is a great start, and it and organizations like it should expand. If we have reason to believe that tithing dollars and other philanthropic support is on the decline, stretching available dollars toward school financing efforts that will make a difference for kids should be a high priority.

Conclusion

At this point, I hope a couple of things are clear. First, more schools and better schools are needed in America. A central tenet of education reform in 2015 should be new school creation, and we should think carefully about how the various programs out there trying to improve schools intersect with schools trying to get off the ground. Second, schools have serious start-up costs that can act as a barrier to new school creation. There is demand, but there is a bottleneck on supply. Many programs and organizations exist to try and solve this problem, but they are small, disjointed, and often exclude private schools. Finally, steps can be taken to help defray the start-up costs of schools. Some of these, such as direct budgetary line items for capital expenses, leave taxpayers on the hook for the entire cost of the project. Others, such as moral obligation pledges, only act as a backstop should the school default. Still others, such as the private capital brought into the system through venture financing, poses no risk to taxpayers at all. Individual states and communities can determine the level to which they want to support schools and the level to which they want to be responsible should schools fail.

People who believe in markets know that they are not magic. Markets fail all the time because of information problems, regulatory issues, and constrictions in the supply of goods and services. Right now, school markets have all three of these problems, but particularly suffer from a kink in the supply hose of new schools. When we look at the problem in the context of school funding writ large, the issues are relatively plain. Schools cannot buy buildings. They cannot invest in technology or hire staff too soon before government dollars start rolling in. This is not a recipe for a high-growth sector. If we believe that we need a high-growth sector, and the thousands upon thousands of students on waiting lists for schools is a strong indicator that we do, we have to get serious about issues of supply and work to solve the kinks in the supply chain. If we do not, we will never see the schools emerge that our children so desperately need.

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