INTERIM REPORT: ANALYSIS OF CSUSA REAL ESTATE BUSINESS PRACTICES

By Pat Hall and Sue Legg, LWVF Education Team, June 2016

Introduction. District school boards grant charter school contracts to private entities and monitor their financial balance sheets, but by legislative intent, they do not have responsibility for their management and operation. Charters have little regulation, and the result has been a continuing saga of scandals. This report goes beyond the mismanagement and corruption issues to the fundamental structure of for-profit management companies, and it questions the accountability of these companies for their use of public funds.

Charters may be self-managed or operated by non-profit or for-profit companies. We focus on one for-profit charter management company, Charter Schools, USA (CSUSA). Florida has several others including, Academica which was the focus of a federal investigation, and Newpoint charters which face indictments. A detailed example of the complex facility transactions for CSUSA's Woodmont K-8 school raises the issue of excessive profiteering. We have data that indicate these business practices are not specific to one school or one company.

CSUSA organizational structure: CSUSA is owned and operated by the CEO, Jonathan Hage. It has multiple interrelated entities whose operations are difficult to track. CSUSA has created six non-profit charter school boards to operate 49 publically funded, privately managed charter schools in 12 Florida counties. Additionally CSUSA operates 17 schools in 6 other states. These non-profit boards subcontract to the CSUSA for-profit educational management firm which founded them.

- **Non Independent Governing Boards:** Basically, the district school board only oversees the charter school board contracts with the charter boards, not the subcontracts with CSUSA. CSUSA charter boards include: Bay Area Charter Foundation (BACF), Inc. (which serve Hillsborough's Henderson Hammock, Winthrop, Woodmont and Southshore Charter Academy charters), Florida Education Foundation of Osceola County, Florida Charter Educational Foundation, Inc., Four Corners Charter School, Inc., Southwest Charter Foundation, Inc., and Renaissance Charter School, Inc.

  These boards subcontract school facilities, personnel and operations to CSUSA. The obligations of the BACF listed in the management contract are as follows "Good faith obligation, Assistance to CSUSA, Unusual events, Retained authority and Food service. As to the building facility—"the board shall lease or otherwise make available a facility to CSUSA".

  Determining who is responsible for which function in the subcontracts is difficult. For example, until 2013, the Bay Area Charter Board was run by the head of the Florida Charter Education Foundation, Ken Haiko. The state's PECO facilities funds justification reports are signed by CSUSA finance staff, not by the charter board as required by Florida law. (From 2012-2015, the 3 schools received $478,322 in PECO state funds.) Tax exemption affidavits, moreover, allow a 10% reduction for lease payments that must be reported to charter boards. For the Bay Area charter board, this is $580,000 for the three schools. We find no evidence of such reports. To add to the confusion, John Hage, the CEO of CSUSA's management company, signed a new lease as president of Red Apple real estate in 2011.

- **Inter related Affiliated Businesses:** CSUSA has three affiliated businesses of which we are aware:

--Red Apple Development Co. is CSUSAs real estate business arm, Scott Woodrey is currently President. Red Apple was created as a holding company in 2007 and is a wholly owned subsidiary of Jonathan Hage, CEO of CSUSA. It is a co-borrower with some charter schools and manages leases.

--Ryan Companies US, Inc. Minneapolis, MN. acquires the properties, makes necessary improvements (Woodmont) and builds new facilities. It has an office in Florida.

--The Florida Charter Educational Foundation, Inc. applies for revenue bonds as a disregarded entity. The Bay Area Charter Foundation is a subsidiary of FCEF. Ken Haiko is the CEO.

--Woodmont LLC is one of four CSUSA charter schools in Hillsborough County.

--Connex12 software development for CSUSA network and non-CSUSA managed schools

Business Operations. Typically, charter school boards, created by CSUSA, subcontract 95% of all operations to CSUSA including: establishing schools, education delivery, technology, human resource management, financial management, strategic improvement, facility maintenance etc. Facilities are leased by the charter boards.

- **Facilities Financing.** Facilities costs for charters run into hundreds of millions of dollars, and payment for these costs are made through state funds and by diverting money from instruction, teacher salaries and benefits. Facilities may be purchased by Red Apple and leased to schools or leases may be arranged with a third party. Loans are often financed through the *Florida Development Finance Corporation* or through the *Church Loans & investments Trust* dba CLI Capital which offers loans for churches, charters, and non-profits.

  The bond funding history we have found is all from Florida Development Finance Corporation which has a connection with Enterprise Florida. In CSUSA's Investor Presentation, listings were as follows:

  Renaissance Charter School, Inc., Series 2010
  Renaissance Charter School, Inc., Series 2011
  Bay Area Charter Foundation, Inc., Series 2011A
  Lee County Community Charter School, LLC., Series 2012

  These bonds were revealed in the newest Woodmont lease. BACF received $30,045,000 in Series 2011A and $7,945,000 in Series 2011B bonds on November 1, 2011. These were in the Investor Presentation. On November 1, 2012 Regions Bank in Tallahassee issued $55,800,000 in Series 2012A tax exempt bonds and $3,520,000 in Series 2012B in taxable bonds. South Florida Business Journal tracked $95,980,000 to finance the sale of Renaissance Charter School in Cooper City and four other charter schools for CSUSA.

- **Lack of transparency for for-profit companies.** Full explanations of leasing and management fees are lacking because for-profit financial disclosure requirements are less stringent than disclosure for non-profit entities. In a North Carolina Law Review article, Kelly (2014) states that charter school operators including CSUSA, if not engaging in clearly illegal activity, are engaging in deceitful practices. He explains, "From a non-profit law perspective, the most troubling aspect of CSUSA's relationship with its schools involves real estate. CSUSA's real estate development affiliate, Red Apple Development, owns the North Carolina charter school facilities, and there is … some evidence to indicate that CSUSA attempted to conceal from state and federal authorities the fact that the schools' EMO (Educational Management Organization) would also, in effect, be their landlord." Similar actions occur in Florida.

At the May 24, 2016 meeting of the Hillsborough County School Board, two CSUSA contracts came up for extension. They read as follows "Charter school contract – 5/24/16 between the School Board (Sponsor) and BACF, LLC. d/b/a Woodmont Charter School, a Florida limited liability company that is taxed as a disregarded entity and wholly-owned by the FCEF, Inc. a Florida not for profit corporation (School)." The purpose was a 5 year extension for Woodmont and a 15 year extension for Winthrop, qualifying as a high performing school, allowing for long term financing.

Lease agreements are signed by the landlord and the chairman of the governing board. The School Board or the School District has no input or refusal ability.

- **Long term lease agreements.** Baker (2015) in *School Finance 101* predicted a charter school finance crash beginning in 2020 due to escalating facility costs and balloon payments. Miron (2015) states "charter schools themselves typically lack the legal authority to guarantee payment of long term debt, so that a charter school board of directors cannot access municipal bond markets. That said, a once removed entity, like a non-profit operator of a collection of charter schools in some states, including Florida, can serve as a co-borrower on a revenue bond…as an example, the Preliminary Official Statement for Renaissance Charter Schools as a co-borrower with Red Apple Development for bonds issued by the Florida Development Finance Corporation. The independent non-profit entity takes on the bond debt/obligation to repay investors both principal and interest, and guarantees those bond payments with revenue generated from lease payments from the charter operator. That is, the lease payment is converted into a loan payment toward capital asset acquisition through the third party."

  New leases, kept from the district Charter Schools General Director for four and a half years, showed up when Pat Hall requested leases for the second time in May, 2016. The new lease agreement between Red Apple at Woodmont, LLC. (Landlord) and Bay Area Charter Foundation, LLC. (Tenant) is now a 45 year term-11/1/2011 to 11/1/2056. The term was 20 years on the old lease with Ryan Construction as landlord. In addition, this new lease reads that both the (Landlord) and (Tenant) share the same address—6245 N. Federal Highway, 5th floor, Ft. Lauderdale, FL 33308. Jon Hage signed this lease as President of Red Apple Woodmont, not as CEO of CSUSA. Ken Haiko signed as President of Bay Area Charter Foundation.

- **Excessive Lease and Management Payments.** Within months after schools are built—the properties are "sold by special warranty deed" by Ryan Construction to Red Apple Development for $1.00 (Woodmont) and $10.00 (Winthrop). These schools are all tax exempt. Lease payments for Woodmont to Red Apple are about $1,325,666 per year. In addition, the charter is required to pay capital lease payments, escalating incrementally, to Red Apple ranging from $9,540 to $135,300 per month through June 2042.

  Facility costs per student at the three Bay Area charters in 2015 were: Woodmont: $2262; Winthrop: $1804; Henderson Hammock: $1337. State funding per student was about $7000. Thus, facility costs alone are about 32% of the budget. According to the 2011-12 report by the National Alliance for Charter Schools, facility costs nationally average 13% percent of charter budgets.

Management fees at CSUSA Hillsborough charters range from \$728,687 to \$979,295 per year with a three percent increase and a maximum of 15% of total revenues per year until 2040.

Possible 'self-enrichment' Business Practice. The Verizon facility that became Woodmont charter was purchased in September 2009 from Verizon, by an entity address that is the same as Woodmont LLC's address, for \$2,600,000. In March 2011, it was sold to Ryan Construction for \$3,750,000. In June 2011, Ryan pulled building permits at \$2,935,441 and subcontracted renovations totaling \$2,110,427. Building permits show renovations for air conditioning, interior painting, electric/plumbing changes, etc. and exterior canopy, door, and paving. Between March and September 2011, the value, based on renovations, increased to \$9,700,000, a nearly \$6 million increase in six months. The current Property Appraiser, Robert Henriquez, was briefly appointed to the BAFC board but resigned in 2014.

- A deed transfer was made in 9/6/2011 from Ryan Construction to Red Apple for \$1.00 with a value set at \$9,700,000. This is the value on which the lease payments from Red Apple to Bay Area charter board are made.
- An Appraiser III of the Property Appraiser office, Greg Sobel, reviewed the 2013 and 2015 cost per square foot analysis from Pat Hall for Hillsborough charters schools from and stated that the three Bay Area charters seemed higher than in other schools/properties. A comparison chart of all 48 charters proved the point. Between 2013-15, moreover, costs psf at Woodmont rose from \$18.16 to \$24.85.

Audit Findings: The Florida Auditor General stated that the audit reports for Woodmont do not clearly identify the different amounts for management and facility costs. Woodmont has a deficit net position of -\$2,113,384 due to lower enrollment than projected. All three Bay Area schools have significant long term debt from over \$12 million to \$17 million.

Next Steps:

1. What indicators in the data show illegal and/or unethical practices? Which other analyses are needed?

2. Which practices have direct financial consequences for the public e.g. facility leases longer than school contracts with districts? What fair market value lease comparisons are applicable?

3. What steps are required to make for-profit business transactions available to charter board members and school districts?

4. Does the debt issued, while tax exempt, qualify as junk bonds or high interest yield because charter schools can dissolve at will?