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Property Investors Bet on Rising Demand for U.S. Charter Schools

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By Brian Louis

Jan. 11 (Bloomberg) -- A warehouse where workers once shaped and cut steel on Milwaukee's north side is getting a second life. It's being transformed into a charter school that's scheduled to open in August.

A joint venture of Canyon Capital Realty Advisors LLC and former tennis champion Andre Agassi's business partnerships is developing the property and will lease it to Lighthouse Academies of Wisconsin Inc. The Canyon-Agassi real estate fund has done one warehouse conversion in Philadelphia and is considering school projects in other U.S. cities, including New York and Houston.

Entertainment Properties Trust and Inland Public Properties Development Inc. also are among companies that are investing in buildings for charter schools as demand for campuses grows. More than 500 of the schools opened last year, bringing the U.S. total to about 5,600, according to the National Alliance for Public Charter Schools, a Washington-based advocacy group. The investors buy or develop properties and get income from renting to companies that operate the schools.

"We don't find a lot of competition right now, and we like that," David Brain, chief executive officer of Entertainment Properties, said in an interview. "We'll be ahead of the curve when other people finally wake up to the idea and come to the party."

The real estate investment trust, primarily a movie theater landlord, owned 34 charter-school properties as of Sept. 30, accounting for \$280.3 million of its \$2.9 billion portfolio. Entertainment Properties spent \$36.4 million on charter schools last year through the third quarter, the Kansas City, Missouri-based company said in a regulatory filing.

'Capacity to Grow'

Charter schools "are going to be a substantial portion of the market and we have a huge capacity to grow there," Brain said.

More than 400,000 children nationwide are on waiting lists for the schools, the national alliance said in a December statement. Demand has increased as parents seek alternatives to traditional public schools. About 2 million students were enrolled in charter schools for the 2011-12 school year, according to the alliance.

The schools charge no tuition. They receive funding from municipal, state and federal tax dollars and operate under a charter that's granted by the state or a local authority, according to a May report by Ernst & Young LLP. Each school has its own governing board.

Academic Focus

Charters are able to offer longer days than traditional public schools and may adopt a focus, such as the arts or preparing for careers, according to the alliance. Like public schools, they're subject to state and federal academic standards.

For Entertainment Properties, the charter-school investment yield is 9 percent to 10 percent, according to Keith Bokota, an analyst at Principal Global Investors. That compares with November's 7 percent average capitalization rate for commercial-property deals of more than \$5 million, according to Real Capital Analytics Inc., a New York-based property research company.

The Canyon-Agassi Charter School's Facilities Fund appeals to investors seeking a good return on their money while doing something positive for education, said Glenn Pierce, its chief executive officer. Investors in the Los Angeles-based fund -- which lists Citigroup Inc., Intel Corp., the Ewing Marion Kauffman Foundation and the University of Michigan among its backers -- can expect yields in the "low teens after fees," he said.

Fund's Goal

The fund has about \$200 million in equity and will use loans to reach its goal of \$500 million to spend on developing campuses, according to Pierce. It's investing about \$5.1 million in the Milwaukee project, he said. The North Point Lighthouse Charter School will have an art room, library and computer lab.

"We're taking a former warehouse building and turning it into a state-of-the-art school," Pierce said in a telephone interview.

The fund gives a school the option to purchase the campus once it has matured to the point where it can obtain financing. "Our whole premise is not to be a long-term owner of these assets," Pierce said.

While school landlords may eventually profit from a sale, income primarily comes from long-term lease agreements with operating companies.

Inland Purchases

In 2010, a unit of Inland American Real Estate Trust Inc., a public, non-traded REIT based in Oak Brook, Illinois, bought seven charter-school properties for \$61 million from operator Imagine Schools Inc. Arlington, Virginia-based Imagine, which runs 75 schools in 12 states and the District of Columbia, agreed to lease back the properties from Inland over a 20-year period.

For Entertainment Properties, income from Imagine accounted for 9 percent of revenue from continuing operations in the third quarter.

Charter schools are "going to be a bigger piece of the business" for the landlord in the long term, Craig Mailman, a New York-based analyst at KeyBanc Capital Markets Inc., said in a telephone interview.

Box office sales in U.S. and Canadian theaters fell 3.4 percent last year, while attendance dropped 4.2 percent to a 16-year low, according to Hollywood.com Box-Office.

Entertainment Properties said it planned to start construction on as many as four campuses in the fourth quarter, according to a Nov. 2 statement.

Investor Risk

Leasing properties can entail risk because schools may be shut down for reasons including poor student achievement, low enrollment and financial troubles. About 150 U.S. charter schools didn't reopen this academic year, according to the charter-school alliance.

"That's just not a risk that's typical of property owners," said Bokota of Principal Global Investors. Its parent company, Des Moines, Iowa-based Principal Financial Group Inc., owned 1.6 million shares of Entertainment Properties at the end of September, according to data compiled by Bloomberg.

Investors may try to reduce risk by leasing to experienced companies that operate a number of schools. The Milwaukee school is part of Lighthouse Academies Inc., a nonprofit network of 19 schools in five states. The Framingham, Massachusetts-based operator was founded in 2003.

Even large operators can run into trouble. Last month, the charter for one of Imagine's schools in St. Louis was revoked and four other schools were placed on probation partly because of poor academic performance. Entertainment Properties is the landlord for those schools' campuses.

Master Lease

Entertainment Properties has a master lease "that covers all the Imagine properties in our portfolio and ensures payment should a school close," Brain, the CEO, said in an e-mailed statement. "We have a variety of options with the facility to continue to serve the education market in St. Louis."

The school is scheduled to close in June.

Improving academic performance "is vital to the schools coming off probation" and the 11-year-old company has taken steps to raise students' test scores, Lori Waters, a spokeswoman for Imagine, said in a telephone interview.

Charter schools' budgets are initially small and the schools often prefer to lease because obtaining financing for a building project is difficult and seen as risky. Many schools start out in temporary space, such as an existing public school building, shuttered retail store or former offices, said Jim Griffin, president of the Colorado League of Charter Schools.

"That's generally their lot in life," he said. "It's kind of get what you can."

Starting Small

Most new charter schools start with just a few grades and try to build enrollment over a number of years. The Lighthouse school in Milwaukee will open for the fall semester with kindergarten through fourth grade and plans to add one class each year until it reaches the 12th grade.

Demolition on the Milwaukee warehouse's interior started last month. Classrooms and offices are expected to be finished in July, a month before classes begin, said Anna Hammernik, the North Point Lighthouse principal.

Hammernik moved back to her native Milwaukee to lead the new school, after working in New Orleans. She's spent the past year helping to plan the curriculum and get the word out.

The old warehouse's transformation will be a "great boost to the community," Hammernik said.

"A lot of our kids go to school in really old buildings," she said. "I'm super-excited for our kids to have a brand-new building."

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