IS IT TIME FOR A CHARTER SCHOOL CREDIT UNION?

AUGUST 2019

NATIONAL ALLIANCE FOR PUBLIC CHARTER SCHOOLS

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TABLE OF CONTENTS

EXECUTIVE SUMMARY

Charter schools have served a diverse set of constituents for over two and a half decades. They have provided valuable academic offerings for students and their families; they have provided rewarding employment for teachers and school staff; and they have created new non-profit organizations advancing innovative approaches to education.

In addition to their academic programming, charter schools have created a marketplace for business services necessary for the ongoing operation of schools. While there has been discussion about creating consolidated services to take advantage of economies of scale (e.g., insurance, procurement, benefits), one intriguing opportunity would be in the financial services sector.

The concept of a charter school credit union has been explored before, and this paper presents some of the key issues surrounding the concept. Traditional public school teachers and staff could take advantage of a wide range of financial services from credit unions. Such services would benefit teachers, staff, students, and families by providing affordable credit, basic deposit services and financial literacy—especially those who are unbanked—and someday might serve alumni with student loans for college.

In addition to serving these groups like traditional credit unions, a charter school credit union could provide loans to charter schools. This would be a new, cheaper, and more flexible source of loan capital, especially for charter school facilities.

This paper explores the concept of starting a federally chartered credit union and identifies methods of creating the field of membership, or those who are served by the credit union. This effort would require patient capital because the process for developing a credit union can take years. It includes preparing a business plan, gaining regulatory approval, raising capital and reaching self-sufficiency. Now that charter schools have been around for more than twenty-five years, a few more years to develop a highly beneficial program may not seem so long anymore.

BACKGROUND

The charter school community brings together a unique combination of charter school organizations, charter school employees, and the families served by charter schools into a cohesive group that aims to improve the educational outcomes for students using an innovative approach to education.

Just like traditional public schools, these groups have the need for myriad services, most of them focused on education, but some focused on support systems, such as financial services. The schools, teachers, and families need access to loans as well as college-planning education, as many students will be the first in their family to attend college.

Forty-three states and the District of Columbia have charter schools, with enrollment of 3.2 million students nationwide. There are 219,000 teachers in charter schools. Over the past ten years, enrollment in charter schools has increased from 1.3 million in 2007–08 to nearly 3.2 million in 2017–18. In 2017–18, 21 school districts had at least 30 percent of their students attending charter schools.

In 2016–17, 57 percent of charter school students were eligible for free-and-reduced-lunch (FRL) services, a higher share of students than the 52 percent of district public school students who were FRL-eligible.

CHARTER SCHOOL COMMUNITY

7,000
ORGANIZATIONS

219,000
EMPLOYEES

3.2 mil
FAMILIES

SERVICES TO OFFER

Over the past several years, a few charter school leaders have been considering a vehicle that could provide loans and financial services to employees and families, while at the same time using its capital to invest in buildings for schools and housing for teachers. Credit unions, with their emphasis on serving members with a common bond, would seem the ideal model for such an institution. Labor union- and employee-based credit unions have been serving this need for decades for the traditional public schools.

The most basic purpose of a credit union is to provide affordable financial services that most American people and companies use every day, such as deposit services, credit and debit cards, and checking and savings accounts. For many of the families of students, these basic services can be hard to access. Many low-income people are unbanked and must use cash checking services that further erode their ability to build assets.

Credit unions, depending on their size, also provide loans, including home mortgages, auto loans, and credit cards to their members. Due to the member-credit union relationship, the credit union is able to be more flexible in its underwriting than most banks. In addition, interest rates on loans are capped, making them more affordable than, for example, credit cards from conventional institutions. A charter school credit union could provide mortgages and car loans to teachers and staff at favorable rates.

A credit union can provide more complex services for some of its members, such as the schools themselves, which may need lines of credit, wiring capabilities, and other business services.

In addition to providing financial services for employees and families, a credit union could also provide financial education and literacy to the students enrolled in the schools. Financial literacy programs have been targeting younger and younger students, as it has become evident that the earlier children receive basic financial education, the more successful they will be as asset-builders and wage-earners. While many schools have relationships with their own community-based credit unions, a national charter school credit union would be unique because it would be based within the school community itself.

Beyond families and employees, foundations and other financial supporters can invest capital in a credit union. In addition to using their capital as grant or seed money on a local level, investors could generate an exponentially greater return that would benefit the charter school movement as a whole. The standard for most credit unions is a leverage rate of 5 to 8 times every dollar of capital. A credit union could also receive Program Related Investments (PRIs) from donor-advised funds throughout the country.

The above-mentioned services apply to the depositors in the credit union. The other, perhaps equally compelling, role for a charter school credit union would be the use of assets.

A charter school credit union could make loans and hold a diversified loan portfolio. The credit union could be a source of loan capital to charter schools.

It could provide operating loans and mortgage loans to charter schools financing their facilities. It could determine through its own loan policy the proportion of its loan portfolio it would limit in charter schools. It could set its loan policy to play various roles in the financing of charter school facilities. This could be another source of hundreds of millions of dollars in loan capital for charter schools on a national scale.

There are credit unions that serve small segments of the K-12 education market. Education First Credit Union serves three counties in Ohio. Some credit unions serve more than just schools but locate their branches in schools. There are six different credit unions with branches located in high schools in Minnesota. The largest credit union serving the educational community is SchoolsFirst Federal Credit Union (FCU) in California, which was originally founded in 1934 as Orange County Teachers Credit Union.

Two credit unions provide a significant amount of loan capital to charter schools in select regions. Self-Help Credit Union (North Carolina) and Hope Enterprise Credit Union (Louisiana) provide loans in the southeast and have deployed millions of dollars in loans to charter schools. They would be good sources of information on the role of credit unions and charter school mortgage loans.

FORMING A CREDIT UNION

The National Credit Union Administration (NCUA) is the regulatory body which charters, oversees, and insures federally chartered credit unions in the United States.

There are three types of credit union charters: single common bond (occupational and associational), multiple common bond (more than one group each having a common bond of occupation or association), and community. A national charter school credit union could be a single or multiple associational common bond. A community is a limited geography and would not apply.

It is important to recognize from the outset that a credit union serves only its members, as reflected by the common bond, or field of membership (FOM). While it is possible to expand the FOM after chartering, any expansion must be approved by the NCUA prior to accepting any members from the expanded FOM. Only members may make deposits and receive services from the credit union. (The exception is low-income credit unions, which are permitted to receive non-member deposits to support the growth of the credit union. Low income credit unions are designated by the NCUA and must, at a minimum, prove that 51 percent of members are low income.) It is therefore critical that any group organizing a credit union be very careful when defining its FOM.

There are two possible credit union charter models: a national charter that would allow charter schools throughout the country to be members of the credit union, and a regional or local credit union charter that would be restricted to one area of the country. Within these two models are five options.

Option 1

A national organization could apply for a national charter if it chooses.

There are several hurdles to the success of this approach. Primarily, the NCUA requires that a proposed credit union provide a business plan that outlines quite specifically how it intends to serve its proposed FOM. While "virtual" credit unions—in which there is no physical service facility—have been attempted, none has been successful to date. In addition, any national organization would have to organize (or re-organize) itself as a membership organization to meet the most basic standard for a credit union charter. For example, the National Association for Public Charter Schools is technically not a membership organization of individual charter schools, but rather it works with state charter school associations. *(See Appendix 1, Threshold Requirement Regarding the Purpose for Which an Associational Group Is Formed and the Totality of the Circumstances Criteria).*

TYPES OF CREDIT UNION CHARTERS

- Single Common Bond
- Multiple Common Bond
- Community

WHAT IS A SINGLE COMMON BOND?

The NCUA's Chartering and Field of Membership Manual states, "A single associational federal credit union may include in its field of membership, regardless of location, all members and employees of a recognized association." It further states: "Generally, a single associational common bond does not include a geographic definition and can operate nationally. However, a proposed or existing federal credit union may limit its field of membership to a single association or geographic area."

U.S.C. Title 12, Part 701

Option 2

A second option would be creation of a credit union with an FOM that is a locally or regionally based association. For example, the District of Columbia has its own association of public charter schools, which could organize a credit union to serve D.C.-based charter schools. This would require that strong networks of charter schools be organized regionally to allow them to be recognized as viable candidates for creating a credit union. A national organization could pick a strong region for the beginning of a credit union.

Once that credit union is successful, its charter could be amended to include other regionally based charter school credit unions.

In that case, the first credit union would apply to change from a single associational common bond to a multiple associational common bond. This model would have one or more physical branches in each region.

Option 3

The third option would be to apply for a charter as a multiple associational common bond from the outset. The NCUA expects that all of the associations included in a multiple common bond structure are within the same service area. If the service area is national, then all of the associations would be national. This model would then have the same issues as a national chartered credit union.

While this would seem to create the same difficulty as the national charter, it would allow for the gradual expansion of the credit union to include other charter school networks as it grows. For example, if the first branch develops a shared branching network or electronic system that allows for full service to other networks, it would be able to include them in its multiple common bond. It is much easier to add another association to a multiple common bond than it is to expand the field of membership.

Option 4

Two additional avenues could be pursued. The fourth option is to partner with an existing credit union to provide services to individual charter schools or tightly knit networks of charter schools. (A detailed example of an existing relationship of this type between AppleTree Early Learning Public Charter Schools in the District of Columbia and the Library of Congress FCU follows below).

There are major advantages to building this kind of relationship.

Existing, successful credit unions can offer a full range of products and services. When a credit union is first organized, the NCUA issues a Letter of Understanding and Agreement (LUA), which limits the size of loans and number of services a

WHAT IS A MULTIPLE COMMON BOND?

The NCUA's Chartering and Field of Member- ship Manual states, "A federal credit union's service area is the area that can reasonably be served by the service facilities accessible to the groups within the field of membership...A service facility for multiple common bond credit unions is defined as a place where shares are accepted for members' accounts, loan applications are accepted or loans are disbursed. This definition includes a credit union-owned branch, a mobile branch, an office operated on a regularly scheduled weekly basis, a credit union-owned ATM, or a credit union-owned electronic facility that meets, at a minimum, these requirements."

U.S.C. Title 12, Part 701

new credit union can offer. This can be a very discouraging stage in the growth of a credit union, given that it has probably taken several years for the credit union to receive its charter and new members will be expecting a fully operating institution. An existing credit union does not face these limitations and will be able to serve new members more fully.

A relationship with an existing credit union will also alleviate other operational issues, such as regulatory compliance, hiring of experienced staff, and development of a knowledgeable Board of Directors. In some instances, existing credit unions will encourage the group it is working with to elect someone to the board to represent their needs, and they may eventually be willing to open a separate branch to serve them. An existing credit union could create specific loan products for the group, and if it is a multiple common bond credit union, it might even add the group to its charter.

Option 5

The final option to be considered is a spin-off. This would require finding an existing credit union that for one reason or another no longer wants to continue its operation. A spin-off occurs when, by agreement of the parties, a portion of the field of membership, assets, liabilities, shares, and capital of a credit union are transferred to a new or existing credit union. One example of this type of circumstance would be a small associational credit union that has seen its membership decline over time and no longer serves its original need.

While this option appears to be a quicker path to a credit union, there are many issues to be considered. The original credit union may be undercapitalized; it may not have cutting-edge technology; and it may have significant liabilities. There are usually financial issues that cause a credit union to request a spin-off that an inexperienced new credit union would be unable to resolve. Therefore, it is unlikely that NCUA would approve this plan.

FIELD EXPERIENCE: EXISTING CREDIT UNIONS SERVING SCHOOLS

AppleTree Institute for Education Innovation, Inc. is a network of free, full-day public charter schools for all three- and four-year olds in locations across Washington, DC. Through their Early Learning Literacy Project, they created a relationship with the Library of Congress Federal Credit Union, which has offered membership to AppleTree's employees. To date, 30% of the employees have joined the credit union and are receiving services. AppleTree has not yet extended membership to the families of students, but this is of interest to them.

In New York City, several community development credit unions have built relationships with public school PTAs throughout the city. For example, Curtis High School PTA in Staten Island, NY, is a select partner group of the LES People's FCU, a multiple common bond credit union. The credit union regularly visits the school to open accounts and provide financial education workshops to students. This relationship was critical to the expansion of the credit union to serve Staten Island.

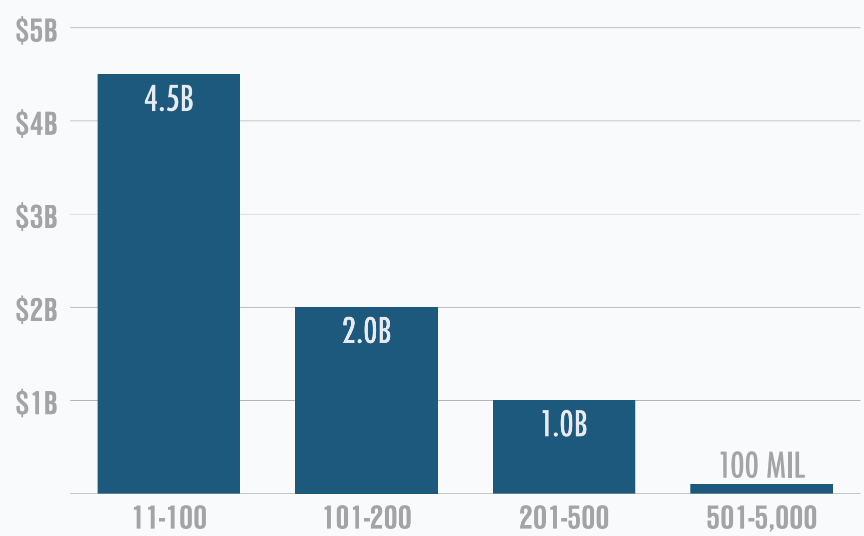
MARKET SIZE

Credit unions take a few years to form. A national credit union would start relatively small and take time to reach its full potential in members served and asset size.

The full potential of a charter school credit union asset size is the combination of charter school assets, employee assets, and student family assets. A rough estimate of the maximum market size is shown at the right.

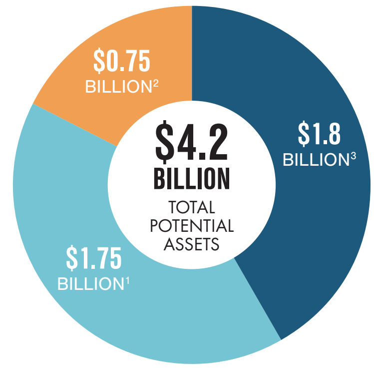
If a national credit union could tap into a 10 to 15 percent market share of schools, and a 5 to 10 percent market share of families and employees, the credit union would have assets in the $300 to 400 million range, once its full potential is reached. For comparative purposes, the asset sizes of credit unions are shown here. (Note that the 10 largest credit unions are outliers and are not shown. The largest credit union, Navy Federal, has assets of over $100 billion!)

ASSET SIZES OF LARGEST CREDIT UNIONS



The total market potential is not a sure sign that a credit union can thrive. The Education Associations Federal Credit Union was chartered in 1954 and served the employees of the National Education Association, other national education organizations and their immediate family members. It served only 665 members and had assets of $2,596,701 when it closed in 2016 due to a lack of viability.

CHARTER SCHOOL CREDIT UNION POTENTIAL



FAMILY ASSETS:
3,000,000 families with an average daily balance of $600

CHARTER SCHOOL ASSETS
7,000 charter schools with an average daily balance of $250,000

EMPLOYEE ASSETS
350,000 employees with an average daily balance of $2,000

1. Assumes annual budget of $10,000 per student x 500 students. Daily balance is 5 percent or 20 days of cash on hand.
2. Federal Reserve, 2016 Survey of Consumer Finances, checking account balance for household income of $45,000
3. Ibid. Assumes only 50 percent of families have accounts with $1,200. Checking account balance for household income of $25,000

FURTHER CONSIDERATIONS

The foregoing provides a basic review of the concept of a charter school credit union. Many steps must be followed before finally receiving a charter from the NCUA.

RECEIVING A CHARTER FROM THE NCUA

- **STEP 1:** An organization must decide which of the various formation options it would like to pursue. Assuming it will choose to create an associational credit union, it would need to organize to be certain it meets the requirements of an approved association. *(See Appendix 1)*

- **STEP 2:** After organization (or reorganization), the applicant would apply for Field of Membership approval from the NCUA. The NCUA readily approves new FOMs, provided the requirements are met.

- **STEP 3:** The credit union applicant would have to begin raising capital for the credit union. The amount of capital needed to start a credit union, assuming that the credit union starts with $50 million in assets, would be a minimum of $500,000, with an additional $500,000 needed in grants for operating costs. *(See Appendix 2.)*

- **STEP 4:** The organizing group would need to begin work on the business plan: proving a market need, providing pro forma financial statements that lead to sustainability, and detailing the services it expects to offer.

- **STEP 5:** Submission of charter package to NCUA, and subsequent negotiations, can take up to three years.

Recent examples of groups that have started credit unions include: Everest FCU, serving the Nepalese Diaspora community in the U.S.; Clean Energy FCU, serving members of the American Solar Energy Society; Civic FCU, serving local government employees in North Carolina; and Otoe-Missouria FCU, serving members and employees of the Otoe-Missouria tribe in Oklahoma.

SUMMARY

The charter school sector could benefit from a credit union that would serve employees and families of the schools, as well as the schools themselves. A credit union could unlock existing capital resources within the charter school sector for schools to benefit in a variety of ways. The charter school sector's demographics would likely allow the credit union to qualify as a "low-income credit union."

There are several options to creating a credit union, - from creating a national associational credit union to partnering with existing credit unions on a local basis. A conservative approach would be to start with partnerships to allow the founding team to develop an understanding of the nature of the work involved in running a credit union. There is no question that NCUA prefers to see some experience on the part of proposed credit unions. The NCUA's Office of Credit Union Resources and Expansion is a good source for assistance in these matters.

ABOUT THE AUTHOR

Linda Levy is the retired Chief Executive Officer of LES People's FCU. She was a member of the original group that organized LES People's FCU and became its first manager and eventually its CEO. She worked for several years with the National Federation of Community Development Credit Unions (now Inclusiv), providing technical assistance to credit union organizing groups across the country. She is currently Treasurer of the Board of Directors of the East Harlem/El Barrio Community Land Trust. This best practice paper was sponsored by the Charter School Facility Center at the National Alliance for Public Charter Schools.

APPENDIX 1

THRESHOLD REQUIREMENT REGARDING THE PURPOSE FOR WHICH AN ASSOCIATIONAL GROUP IS FORMED AND THE TOTALITY OF THE CIRCUMSTANCES CRITERIA

From *NCUA Chartering and Field of Membership Manual*

III.A.1.a—Threshold Requirement Regarding the Purpose for Which an Associational Group Is Formed and the Totality of the Circumstances Criteria

As a threshold matter, when reviewing an application to include an association in a federal credit union's field of membership, NCUA will determine if the association has been formed primarily for the purpose of expanding credit union membership. If NCUA makes such a determination, then the analysis ends and the association is denied inclusion in the federal credit union's field of membership. If NCUA determines that the association was formed to serve some other separate function as an organization, then NCUA will apply the following totality of the circumstances test to determine if the association satisfies the associational common bond requirements. The totality of the circumstances test consists of the following factors:

1. Whether the association provides opportunities for members to participate in the furtherance of the goals of the association;
2. Whether the association maintains a membership list;
3. Whether the association sponsors other activities;
4. Whether the association's membership eligibility requirements are authoritative;
5. Whether members pay dues;
6. Whether the members have voting rights; to meet this requirement, members need not vote directly for an officer, but may vote for a delegate who in turn represents the members' interests;
7. The frequency of meetings; and
8. Separateness—NCUA reviews if there is corporate separateness between the group and the federal credit union. The group and the federal credit union must operate in a way that demonstrates the separate corporate existence of each entity. Specifically, this means the federal credit union's and the group's respective business transactions, accounts, and corporate records are not intermingled.

No one factor alone is determinative of membership eligibility as an association. The totality of the circumstances controls over any individual factor in the test. However, NCUA's primary focus will be on factors 1-4.

APPENDIX 2

ECONOMIC ADVISABILITY: MEMBER SUPPORT AND CAPITAL

From *NCUA Chartering and Field of Membership Manual*

IV.C Member Support

Economic advisability is a major factor in determining whether the credit union will be chartered. An important consideration is the degree of support from the field of membership. The charter applicant must be able to demonstrate that membership support is sufficient to ensure viability.

NCUA has not set a minimum field of membership size for chartering a federal credit union. Consequently, groups of any size may apply for a credit union charter and be approved if they demonstrate economic advisability. However, it is important to note that often the size of the group is indicative of the potential for success. For that reason, a charter application with fewer than 3,000 primary potential members (e.g., employees of a corporation or members of an association) may not be economically advisable. Therefore, a charter applicant with a proposed field of membership of fewer than 3,000 primary potential members may have to provide more support than an applicant with a larger field of membership. For example, a small occupational or associational group may be required to demonstrate a commitment for long-term support from the sponsor.

IV.D Present and Future Market Conditions: Business Plan

The ability to provide effective service to members, to compete in the marketplace, and to adapt to changing market conditions are key to the survival of any enterprise. Before NCUA will charter a credit union, a business plan based on realistic and supportable projections and assumptions must be submitted.

The business plan should contain, at a minimum, the following elements:

- Mission statement;
- Analysis of market conditions, including if applicable, geographic, demographic, employment, income, housing, and other economic data;
- Evidence of member support;
- Goals for shares, loans, and for number of members;
- Financial services needed/desired;

- Financial services to be provided to members of all segments within the field of membership;
- How/when services are to be implemented;
- Organizational/management plan addressing qualification and planned training of officials/employees;
- Continuity plan for directors, committee members and management staff;
- Operating facilities, to include office space/equipment and supplies, safeguarding of assets, insurance coverage, etc.;
- Type of record-keeping and data processing system;
- Detailed semiannual pro forma financial statements (balance sheet, income and expense projections) for 1st and 2nd year, including assumptions—e.g., loan and dividend rates;
- Plans for operating independently;
- Written policies (shares, lending, investments, funds management, capital accumulation, dividends, collections, etc.);
- Source of funds to pay expenses during initial months of operation, including any subsidies, assistance, etc., and terms or conditions of such resources; and
- Evidence of sponsor commitment (or other source of support) if subsidies are critical to success of the federal credit union. Evidence may be in the form of letters, contracts, financial statements from the sponsor, and any other such document on which the proposed federal credit union can substantiate its projections. While the business plan may be prepared with outside assistance, the subscribers and proposed officials must understand and support the submitted business plan.

CHARTER SCHOOL
FACILITY
CENTER
AT THE NATIONAL ALLIANCE FOR
PUBLIC CHARTER SCHOOLS

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