

Are We Heading Toward a Charter School “Bubble”? Lessons from the Subprime Mortgage Crisis

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Introduction

Since 1992, 43 states and the District of Columbia have passed charter school legislation.¹ Charter schools are commonly defined as public schools that are given considerable latitude from state rules and regulations that apply to traditional public schools while being held accountable for student achievement.² There are more than 6,700 charter schools nationwide, serving nearly 3 million students, which accounts for 6% of public school enrollment.³

Charter school advocates have called for the removal of obstacles that limit their expansion, such as the lack of charter school authorizer options, and caps on the number of charter schools allowed within a state.⁴ The federal government has also sought to increase charter school growth through financial incentive programs like Race to the Top, which

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¹ Sara Mead *et al.*, *The State of the Charter School Movement* 37 (Sep. 2015), <http://bellwethereducation.org/sites/default/files/Charter%20Research%200908%20FINAL.pdf>.

² Nat'l Alliance for Pub. Charter Schs., *What Are Public Charter Schools?*, <http://www.publiccharters.org/get-the-facts/public-charter-schools/>.

³ Mead *et al.*, *supra* note 1, at 3.

⁴ *See, e.g.*, Ctr. for Educ. Reform, *Charter School Laws Across the States: 2015 Rankings and Scorecard*, <https://www.edreform.com/wp-content/uploads/2015/07/CharterLaws2015.pdf>; Elizabeth G. Hill, *Assessing California's Charter Schools* (Jan. 2004), http://www.lao.ca.gov/2004/charter_schools/012004_charter_schools.pdf; Illinois Policy, *Why Aren't There More Charter Schools in Illinois?* (Jan. 2008), <https://www.illinoispolicy.org/reports/why-arent-there-more-charter-schools-in-illinois/>; PennCan, *Expand High-quality Choices for Families* (May 2012), <http://www.publiccharters.org/get-the-facts/public-charter-schools/>.

authorized the U.S. Department of Education to expand support for high-performing charter schools.⁵

However, charter schools have also been plagued by scandal both in terms of financial management and with respect to student discipline. For instance, two governmental watchdog groups claimed to have uncovered \$200 million in charter school fraud, abuse, and mismanagement in 15 states.⁶ And a report of the disciplinary practices of Chicago schools revealed that charter schools expelled 61 of every 10,000 students, while district-run schools expelled only 5 out of every 10,000 students.⁷

Mark Naison, a professor of African American Studies and History at Fordham University, has claimed that the charter school scandals are beginning to resemble the subprime mortgage crisis.⁸ Subprime mortgages were loans offered by financial institutions to persons whose financial standing was too weak to qualify for a typical mortgage at the prevailing interest rate.⁹ To protect lenders, these mortgages were issued at much higher interest rates, with foreclosure as the penalty of default.¹⁰ Despite the risk to subprime borrowers, the federal government sought to increase homeownership among the working class and minorities by encouraging subprime lending.¹¹ As a result, seeing an opportunity, private lenders entered into

⁵ U.S. Dep't of Educ., *States Open to Charters Start Fast in "Race to Top": Education Secretary Seeking Autonomy with Real Accountability for School Innovators* (Jun. 8, 2009), <http://www2.ed.gov/news/pressreleases/2009/06/06082009a.html>.

⁶ Ctr. for Democracy & Alliance to Reclaim Our Schools, *The Tip of the Iceberg: Charter School Vulnerability to Waste, Fraud, and Abuse: Escalating Fraud Warrants Immediate Federal and State Action to Protect Public Dollars and Prevent Financial Mismanagement* (Apr. 2015), http://populardemocracy.org/sites/default/files/Charter-Schools-National-Report_rev2.pdf.

⁷ Noreen S. Ahmed-Ullah & Alex Richards, *CPS: Expulsion Rate Higher at Charter Schools*, CHIC. TRIB., Feb. 26, 2014, http://articles.chicagotribune.com/2014-02-26/news/ct-chicago-schools-discipline-met-20140226_1_charter-schools-andrew-broy-district-run-schools.

⁸ Mark Naison, *Why Charter School Scandals Resemble the Subprime Mortgage Crisis* (Jul. 8, 2014), <http://withabrooklynaccent.blogspot.com/2014/07/why-charter-school-scandals-resemble.html>.

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

the subprime mortgage market in earnest.¹² Their aggressive lending practices created a housing bubble, in which the value of residential real estate rose to artificially high, unsustainable levels.¹³ This bubble burst and home values plummeted, when subprime borrowers were unable to keep up with their mortgages.¹⁴ Not only did the housing bubble cause the virtual collapse of the housing industry, but it also contributed to a worldwide recession.

With respect to charter schools, Naison asserted that, similar to the subprime mortgage situation, the federal government encouraged the charter school sector to expand with little oversight. As a consequence, Naison explained that charter schools are experiencing abusive practices at a level resembling the subprime mortgage crisis. These abuses have taken on two forms: (1) mistreatment of students and teachers (e.g. the refusal to educate special needs and English Language learners); and (2) financial issues, such as embezzlement and real estate fraud.¹⁵

In this article, we explain how Mark Naison may be correct in asserting that charter schools are developing conditions that are reminiscent of the subprime mortgage crisis. The first section explains how the federal government helped to create the subprime mortgage crisis by creating an alternate mortgage origination structure – i.e. the “originate-to-distribute” (OTD) model – that increased the number of mortgages by removing the risk of default to mortgage lenders. While OTD mortgage origination enabled mortgage originators to increase the number of mortgages, it also removed the incentive for originators to engage in screening, which in turn led to excessive foreclosures. This section then explains how the adoption of multiple authorizers might create similar conditions in the charter school sector.

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

The second section explains how the OTD model created a principal-agent problem between mortgage investors and mortgage servicers. On the one hand, mortgage investors (principal) wished to maximize the value of loans that were in danger of foreclosure. On the other hand, mortgage servicers (agent) had the incentive to engage in automated default administration, which led to excessive foreclosures, instead of more expensive hands-on loss mitigation. This section then discusses how a similar principal-agent problem between charter school boards (principal) and education management organizations (EMOs) (agent) incentivizes EMOs to cut corners with regards to the servicing of charter schools.

The third section examines the predatory practices associated with the subprime mortgage crisis. As the profitability of these loans soared, various mortgage servicers used questionable practices to lure vulnerable populations to take out loans that were not in their best interests. The section then discusses instances when charter schools have likewise been accused of predatory practices in order to boost enrollment.

The fourth section explains what a “bubble” might look like in the charter school sector. Employing the policy bubble framework developed by Moshe Maor,¹⁶ we explain how the combination of multiple authorizers and EMOs might work together to create an abundance of poor performing schools in Black, urban communities. We also discuss the process by which such a bubble might actually burst in the process, creating disarray in these communities. The final section discusses the steps that federal and state governments should take to avoid the creation of policy bubbles in these vulnerable neighborhoods.

¹⁶ Moshe Maor, *Policy Bubbles: Policy Overreaction and Positive Feedback*, 27 GOVERNANCE 469 (2014).

I. Granting Structures That Increase Participation, While Lessening Screening Standards

A. Subprime Mortgages

Under the traditional originate-to-hold model of mortgage origination, banks and savings and loans (S&Ls) originated and serviced the loans that they held in their portfolios.¹⁷ Because of the risk of default on the part of borrowers, they lent only to “prime borrowers,” who posed little risk of default, instead of “subprime borrowers” with less-than-perfect credit.¹⁸ The originate-to-hold model prevented the expansion of homeownership by not only limiting mortgage origination, but also restricting the development of a secondary mortgage market, where mortgage loans were bought and sold.¹⁹

In the 1970s, the federal government-sponsored-enterprises (GSEs) engaged in housing – the Federal National Mortgage Association (“Freddie Mac”) and the Federal Home Loan Mortgage Association (“Fannie Mae”) – sought to increase homeownership by adopting the OTD model of mortgage origination.²⁰ Fannie Mae and Freddie Mac purchased mortgages from participating lending institutions, pooled these mortgages together, and then converted the loans into more liquid, flexible instruments.²¹ The mortgage originators who had sold their mortgages to the GSEs made money from the fees generated from selling the loans to the GSEs.²² Mortgage

¹⁷ JAMES BARTH, *THE RISE AND FALL OF THE U.S. MORTGAGE AND CREDIT MARKETS: A COMPREHENSIVE ANALYSIS OF THE MARKET MELTDOWN* 23 (Wiley, 2009).

¹⁸ Janice Kay McClendon, *The Perfect Storm: How Mortgage-Backed Securities, Federal Deregulation, and Corporate Greed Provide a Wake-Up Call for Reforming Executive Compensation*, 12 U. PENN. J. BUS. L. 131, 139-40 (2009).

¹⁹ *Id.* at 140.

²⁰ Peter M. Carozzo, *Marketing the American Mortgage: The Emergency Home Finance Act of 1970, Standardization and the Secondary Market Revolution*, 39 REAL PROP. & TR. J. 765, 800 (2005); Richard J. Rosen, *The Impact of the Originate-to-Distribute Model on Banks Before and During the Financial Crisis* (Mar. 2011), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1719612.

²¹ Carozzo, *supra* note 20, at 800.

²² Sumit Agarwal *et al.*, *Adverse Selection in Mortgage Securitization* 4 (2008), https://www.fdic.gov/bank/analytical/cfr/mortgage_future_house_finance/papers/Chang.PDF.

originators could also issue more mortgages because the GSEs offered guarantees against mortgage default.²³ During this period, private financial institutions also began engaging in mortgage securitization in which, they originated loans, collected the fees, and then sold the mortgages to investors.²⁴ Thus, these originators were free to issue more mortgages because they had passed on the default risk to investors.²⁵

Beginning in the 1980s, the federal government also sought to encourage homeownership by deregulating the financial industry, so that it, too, could increase its involvement in mortgage securitization.²⁶ The Depository Deregulation and Monetary Control Act of 1980 encouraged subprime lending by easing interest rate restrictions, preempting state usury laws, and allowing for higher loan-to-value ratios, i.e. the ratio of the mortgage loan to the value of the property.²⁷ The Alternative Mortgage Transaction Parity Act of 1982 preempted state laws that prohibited banks from originating mortgages except conventional fixed-rate mortgages. Banks were allowed to issue adjustable-rate mortgages, balloon-payment mortgages, and interest-only mortgages, which were the hallmarks of subprime mortgages.²⁸ The Secondary Mortgage Market Enhancement Act of 1984 encouraged private mortgage securitization by declaring private mortgage-backed securities equivalent to those created by federal agencies including GSEs.²⁹ Finally, the Financial Services Modernization Act of 1999 permitted banks, security firms, and

²³ *Id.*

²⁴ Carozzo, *supra* note 20, at 801.

²⁵ Agarwal *et al.*, *supra* note 22, at 4.

²⁶ McClendon, *supra* note 18, at 143.

²⁷ Depository Institution Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (codified in scattered parts of United States Code Title 12), cited by McClendon, *supra* note 18, at 143-44.

²⁸ Alternate Mortgage Transaction Parity Act of 1982, 12 U.S.C.A. § 3801 *et seq.* (2015), cited by McClendon, *supra* note 18, at 144.

²⁹ Secondary Mortgage Enhancement Act, Pub. L. No. 98-440, 98 Stat. 1689 (codified in scattered section of United States Code Titles 12 and 15), cited by McClendon, *supra* note 18, at 144.

insurance companies to merge into large conglomerates, thus increasing their capacity to engage in mortgage securitization.³⁰

In the 1990s, the federal government further promoted private participation in securitization by setting fair housing goals for the GSEs to increase homeownership among disadvantaged groups. For instance, the Housing and Community Development Act of 1992 changed the mission of Fannie Mae and Freddie Mac to service “the mortgage finance needs of low-and-moderate-income persons, racial minorities and inner-city residents.”³¹ Originally, the legislation required 30% of the GSE’s purchases to be related to affordable housing.³² During the Clinton Administration, the Department of Housing and Urban Development (HUD) increased the quota to 50%.³³ In 2005, HUD increased the affordable housing goals for the next four years from 50% to 56%.³⁴

Although the Housing and Community Development Act did not specifically call for GSEs to become involved in the subprime market, the targets set by HUD forced the GSEs to lower underwriting standards.³⁵ In late 1994, after HUD announced its affordable housing goal in 1995, the GSEs reduced their down payment requirements to 3 percent.³⁶ In 2000, after HUD raised the affordable housing goals to 50%, the GSEs required no down payments for its mortgages.³⁷

³⁰ Financial Services Modernization Act of 1999, 15 U.S.C.A. § 6701 *et seq.* (2015), cited by McClendon, *supra* note 18, at 144-45.

³¹ Report of the Committee on Banking Housing and Urban Affairs, United States Senate to accompany S. 2733. Report 102-282, May 15, 1992, pp.34-35.

³² Richard A. Epstein, *The Government Takeover of Fannie Mae and Freddie Mac: Upending Capital Markets with Lax Business and Constitutional Standards*, 10 N.Y.U. J.L. & BUS. 379, 386 (2014).

³³ McClendon, *supra* note 18, at 145-46.

³⁴ *Id.* at 146.

³⁵ Peter J. Wallison & Edward J. Pinto, *Free Fall: How Government Policies Brought Down the Housing Market* (Apr. 26, 2012), <https://www.aei.org/publication/free-fall-how-government-policies-brought-down-the-housing-market/>.

³⁶ *Id.*

³⁷ *Id.*

The federal government's promotion of the OTD mortgage origination model led to a dramatic increase in homeownership. Between 1995 and 2004, homeownership rose from 64% – where it had been for 30 years – to more than 69%.³⁸ The adoption of the OTD model also led to an increase in subprime loan originations. In 2002, \$200 billion in subprime mortgages were originated, accounting for 7.4% of mortgage originations.³⁹ By 2006, the totals rose to \$600 billion, which constituted 20% of mortgage originations.⁴⁰

While the OTD model enabled mortgage originators to issue more mortgages by transferring the risk of borrower default, several analysts have asserted that this lending approach also had the negative effect of interfering with the lending institutions' screening practices.⁴¹ Because mortgage originators did not have to live with the consequences of bad lending decisions, their incentives to screen and monitor decreased.⁴² As a consequence, lending institutions generated a large number of low-quality mortgages on which borrowers later defaulted.⁴³

For example, Benjamin Keyes and associates examined one million home purchase loans from 2001 to 2006.⁴⁴ To determine whether securitization reduced the effectiveness of screening, the researchers used a rule of thumb of a FICO cutoff score of 620 for accepting loans.⁴⁵ The

³⁸ Ronald D. Utt, *The Subprime Mortgage Market Collapse: A Primer on the Causes and Possible Solutions* (Apr. 22, 2008), <http://www.heritage.org/research/reports/2008/04/the-subprime-mortgage-market-collapse-a-primer-on-the-causes-and-possible-solutions>.

³⁹ Dean Starkman, *Power Problem: The Business Press Did Everything But Take on the Institutions That Brought Down the Financial System* (May/Jun. 2009), http://www.cjr.org/cover_story/power_problem.php?page=all&print=true.

⁴⁰ *Id.*

⁴¹ Benjamin J. Keyes *et al.*, *Did Securitization Lead to Lax Screening: Evidence from Subprime Loans*, 125 QUART. J. ECON. 307 (2010); Amiyatosh Purnanandam, *Originate-to-distribute Model and the Subprime Mortgage Crisis*, 24 REV. OF FIN. STUDIES 1881 (2011).

⁴² Keyes, *supra* note 41, at 308.

⁴³ *Id.*

⁴⁴ *Id.* at 310.

⁴⁵ *Id.* FICO is a type of credit score that lenders use to evaluate a loan applicant's credit risk. Persons with FICO scores below 620 have a difficult time obtaining funding at a favorable rate. Investopedia, *FICO Score*, <http://www.investopedia.com/terms/f/ficoscore.asp>.

authors found that the number of securitized loans dramatically increased when the credit threshold moved from 620⁻ to 620⁺.⁴⁶ Surprisingly, the authors also found that the loans just above the FICO threshold defaulted at much higher rates than their counterparts that fell just below.⁴⁷ These findings indicated that securitization practices negatively affected the screening incentives of lenders.⁴⁸

Amiyatosh Purnanandam also examined the relationship between securitization and screening by comparing the performance of banks with large quantities of OTD loans with their counterparts with low numbers of such loans prior to the first quarter of 2007, the period right before the start of the subprime mortgage crisis.⁴⁹ This researcher hypothesized that banks with heavy exposure to the OTD market spent fewer resources on screening mortgages.⁵⁰ The study found that high-OTD banks had significantly higher defaults than low-OTD banks, which the author reasoned was evidence that high-OTD loans were of lower quality.⁵¹

B. Charter Schools

Proponents of charter schools argue that this school choice option provides a “viable public alternative” for students stuck in poor-performing urban school districts.⁵² According to the National Alliance for Public Charter Schools, thousands of students in urban districts are on waiting lists for charter schools, including 163,000 in New York City, 35,000 in Houston, and 25,700 in Boston.⁵³ According to advocates of charter school expansion, a major reason for

⁴⁶ Keyes *et al.*, *supra* note 41, at 310.

⁴⁷ *Id.* at 336.

⁴⁸ *Id.* at 354-55.

⁴⁹ Purnandanam, *supra* note 41, at 1883.

⁵⁰ *Id.* at 1882.

⁵¹ *Id.* at 1912.

⁵² Susan Pendergass & Nora Kern, *Waiting for Their Chance: A Closer Look at Wait Lists in Urban Public Charter Schools* 3 (May 2015), http://www.publiccharters.org/wp-content/uploads/2015/05/waitlist_web.pdf.

⁵³ *Id.*

charter school waiting lists is the lack of charter school authorizing options.⁵⁴ Charter school authorizers play a role similar to mortgage originators in that they decide whether to issue charters.⁵⁵ According to the National Association of Charter School Authorizers (NACSA), there are six types of charter school authorizers: (1) state education agencies; (2) local education agencies; (3) higher education institutions; (4) nonprofit organizations; (5) independent charter school boards; and (6) non educational government entities.⁵⁶ Most charter school authorizers are local education agencies (LEAs). In 2013, they comprised 945 out of 1,045, or 90% of authorizers.⁵⁷ However, LEAs serve as the authorizer for only a little more than half of all charter schools because most LEA authorizers oversee five or fewer charter schools.⁵⁸

Because of the reluctance of LEAs to issue a large number of charters, supporters of charter school expansion have called for states to increase the number of independent authorizers, such as higher education institutions and nonprofit organizations, which are not beholden to LEAs.⁵⁹ According to the Center for Education Reform, states with multiple charter school authorizers have nearly three and a half times as many charter schools as those states that allow only LEA authorization.⁶⁰ Audrye Wong has also found that permissive laws, which include multiple authorizers, are associated with an increase in charter schools.⁶¹

Supporters of charter school expansion claim that multiple authorizers increase the number of charter schools by: (1) serving as a “check,” which prevents LEAs from developing

⁵⁴ See, e.g., Ctr. for Educ. Reform, *The Importance of Multiple Authorizers* (Dec. 2011), <https://www.edreform.com/wp-content/uploads/2012/05/CERPrimerMultipleAuthorizersDec2011.pdf>; Hill, *supra* note 4; PennCan, *supra* note 4.

⁵⁵ Nat’l Ass’n of Charter Sch. Authorizers, *The State of Charter School Authorizing* 10 (2013), http://www.qualitycharters.org/wp-content/uploads/2015/08/NACSA_2013-SOCA.pdf.

⁵⁶ *Id.* at 3.

⁵⁷ *Id.* at 4.

⁵⁸ *Id.*

⁵⁹ Ctr. for Educ. Reform, *supra* note 54; Travis Pillow, *How Advocates Think Florida Could Improve Its Charter School Law* (Jan. 28, 2015), <http://www.redefinedonline.org/2015/01/floridas-charter-school-laws-get-better-marks-advocates/>.

⁶⁰ Ctr. for Educ. Reform, *supra* note 54.

⁶¹ Audrye Wong, *State Charter Law and Charter School Outcomes*, 11 MICH. J. PUB. AFF. 103, 115 (2014).

cumbersome application processes; (2) providing charter schools with an alternative in situations where the LEA is hostile toward charter schools; and (3) attracting national providers who do not wish to work with school district authorizers.⁶²

However, the subprime mortgage saga suggests an alternate reason as to why LEAs may be reluctant to authorize a high number of charter schools. If a charter school authorized by an LEA is closed, that LEA still has the duty to educate the children who have been attending that charter school.⁶³ It is easy to see how absorbing dislocated students into the remaining traditional public schools would cause logistical and financial hardships. Thus, the hesitancy of LEAs to issue many charters may be due to concerns similar to those of lending institutions under the traditional originate-to-hold model of mortgage origination.

The subprime mortgage crisis also provides an explanation as to why independent authorizers might be more likely to approve charters than LEAs. In the case of charter school failure, independent authorizers generally do not have the responsibility of educating the children who have been displaced.⁶⁴ Therefore, independent authorizers are in a position similar to OTD mortgage originators in that they are freer to issue more charters because they do not assume the risk of charter school failure.

Furthermore, similar to OTD loan origination, two studies have found that the existence of multiple authorizers may have a negative impact on charter school screening practices. In the case of charter school authorizers, insufficient screening was reflected in poor academic performance. The first study, conducted by Stanford University's Center for Research on

⁶² Joseph A. Giambrone, *Advancing the Charter School Movement in Illinois through Charter School Law: The Charter School Quality Law and Multiple Authorizers*, 61 DEPAUL L. REV. 1213, 1227-28 (2012).

⁶³ Suzanne E. Eckes *et al.*, *Charter School Accountability: Legal Considerations Concerning Nonrenewal and Revocation Procedures*, 2006 B.Y.U. EDUC. & L. J. 551, 559 (2006).

⁶⁴ See Ariana Prothero, *Charter Sector Is Confronting School Closures*, EDUC. WK., Nov. 5, 2014 (“[R]egardless of how smoothly charter students make the transition to new schools, the influx affects campuses on the receiving end, which are often regular district schools.”).

Education Outcomes (CREDO), looked at charter school performance across 16 states on the National Assessment for Education Progress (NAEP) tests.⁶⁵ The CREDO study found, *inter alia*, that states with multiple authorizers experienced a significantly lower growth in academic learning in their charter school students.⁶⁶ According to CREDO, this finding indicated that charter school operators were able to identify and choose the least rigorous option to provide oversight.⁶⁷

Audrye Wong reached a similar conclusion in her study of the impact of the state's legal environment on the academic performance of charter school students. While Wong found that permissive laws, which include multiple authorizers, were correlated with an increase in charter schools, she also found that permissive laws had a significantly negative correlation with academic outcomes as measured by NAEP performance. Wong posited that independent authorizers have less rigorous standards than LEAs "who may be more demanding or even skeptical of charters because charters directly affect the operations of public schools."⁶⁸ Consequently, Wong reasoned, "[t]he availability of multiple authorizers makes the approval process easier as applicants can work outside the usual governmental bodies to find an authorizer with less rigorous standards."⁶⁹

Charter schools have also taken advantage of the availability of multiple authorizers by engaging in "authorizer hopping."⁷⁰ Authorizer hopping occurs when a low-performing charter school switches to a new authorizer to avoid accountability measures, such as school closures.⁷¹

⁶⁵ CTR. FOR RESEARCH ON EDUC. OUTCOMES, MULTIPLE CHOICE: CHARTER SCHOOL PERFORMANCE IN 16 STATES (Jun. 2009), http://credo.stanford.edu/reports/MULTIPLE_CHOICE_CREDO.pdf.

⁶⁶ *Id.* at 40.

⁶⁷ *Id.*

⁶⁸ Wong, *supra* note 61, at 116.

⁶⁹ *Id.*

⁷⁰ Nat'l Ass'n of Charter Sch. Authorizers, *Authorizer Hopping: Motivations, Causes, and Ways to Stop It*, http://www.qualitycharters.org/wp-content/uploads/2015/08/PolicyBrief_AuthorizerHopping.pdf.

⁷¹ *Id.* at 2.

Authorizer hopping usually occurs in one of two ways: (1) the charter school can pursue a contract with a new authorizer once the school's existing charter has not been renewed or revoked; or (2) the charter school can transfer to a new authorizer during the term of the charter, once it becomes clear that the present authorizer will revoke or not renew the school's contract.⁷²

II. The Principal-Agent Problem

A. Subprime Mortgages

Analysts have also argued that the OTD model helped to cause the subprime mortgage crisis by altering the ways in which loans were serviced.⁷³ Mortgage servicing refers to the administration of the mortgages and includes such activities as collecting payments from mortgage borrowers and foreclosing mortgages that are in default.⁷⁴ Under the traditional originate-to-hold model, the lending institutions that originated the mortgage also serviced the mortgage.⁷⁵ By contrast, under the OTD model, securitization trusts, which were passive for taxing purposes, owned the mortgages on behalf of investors.⁷⁶ An industry of third-party mortgage servicers thus emerged to service these loans on behalf of the securitization trusts.⁷⁷

⁷² *Id.*

⁷³ Adam J. Levitin & Tara Twomey, *Mortgaging Servicing*, 28 YALE J. ON REG. 1 (2011); Samuel Kruger, *The Effect of Mortgage Securitization on Foreclosure and Modification* (Jan. 2014), <https://www.mcombs.utexas.edu/~media/Files/MSB/Centers/REFIC/2014%20Summer%20Symposium/Securitization%20and%20Foreclosure1.pdf>.

⁷⁴ Levitin & Twomey, *supra* note 73, at 23.

⁷⁵ Governor Sarah Boom Raskin, Speech at the Nat'l Consumer Law Ctr's. Consumer Rights Litigation Conference (Nov. 12, 2010), <http://www.federalreserve.gov/newsevents/speech/raskin20101112a.htm>.

⁷⁶ *Id.*

⁷⁷ *Id.*

Mortgage servicing duties and compensation were established in a pooling and servicing agreement (PSA).⁷⁸ Compensation included servicing fees, float, and ancillary fees collected from mortgage borrowers.⁷⁹ Mortgage servicers derived a great deal of income from ancillary fees, which are charges imposed on borrowers for reimbursement for servicing activities, such as late payments, bounced checks, and foreclosures.⁸⁰

There was a significant difference between how mortgage servicers addressed mortgage defaults under the traditional and OTD models. Under the traditional model, if a loan defaulted, then the lender took steps to maximize the value of the loan. Because traditional lenders had an undivided interest in the performance of the mortgage, they fully internalized the costs and benefits as to whether to restructure or foreclose on a loan in default.⁸¹ By contrast, the compensation structure of OTD mortgage servicing created a principal-agent problem between mortgage investors and servicers. On the one hand, investors in mortgage securities (principal) wished to maximize the values of loans that are in default.⁸² On the other hand, mortgage servicers (agent) did not have an interest in the performance of the loan because their compensation is based on fees.⁸³ Therefore, mortgage servicers, in direct conflict with their official mandate of maximizing returns for investors, had more incentive to engage in automated foreclosure instead of more expensive hands-on intervention, which could reduce their compensation.⁸⁴

Neither securitization trustees nor legal structures were sufficient to successfully resolve this principal-agent problem during the subprime mortgage crisis. Trustee monitoring was

⁷⁸ Levitin & Twomey, *supra* note 73, at 31.

⁷⁹ *Id.* at 37-48.

⁸⁰ *Id.* at 41-45.

⁸¹ Raskin, *supra* note 75.

⁸² Levitin & Twomey, *supra* note 73, at 71.

⁸³ *Id.*

⁸⁴ Kruger, *supra* note 73, at 25.

generally passive.⁸⁵ For instance, trustees waited for servicers' data reporting, but had little obligation to analyze it.⁸⁶ Also, trustees had little incentive to fire servicers because they have to take the servicers' place if another servicer cannot be found.⁸⁷ Trustee monitoring was further compromised by the fact that many trustees have conflicts of interest, such as close business relationships with the servicers whom they were supposed to oversee.⁸⁸

The failure to correct the principal-agent problem in mortgage servicing exacerbated the subprime mortgage crisis because mortgage servicers had the incentive to foreclose loans instead of engaging in loss mitigation. Samuel Kruger estimated that "[t]he bias of securitized loans towards foreclosure and away from modification" caused more than 500,000 of the 4.4 million foreclosures that occurred since the start of the financial crisis.⁸⁹

B. Charter Schools

In the case of charter schools, private education management organizations (EMOs) play a role similar to mortgage servicers. Charter school governing boards, which consist of appointed groups of private citizens, hire EMOs to manage some or all of the day-to-day operations of charter schools.⁹⁰ Charter boards pay management fees to the EMOs or transfer the public funding to the EMOs, which then extract management expenses.⁹¹ EMOs can be for-profit or non-profit.⁹² In 2014-15, it was estimated that 100 for-profit EMOs operated more than 900

⁸⁵ Levitin & Twomey, *supra* note 73, at 60.

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.* at 62.

⁸⁹ Kruger, *supra* note 73, at 31.

⁹⁰ Bruce Baker & Gary Miron, *The Business of Charter Schooling: Understanding the Policies that Charter Operators Use for Financial Benefit* 11-12 (Dec. 2015), <http://nepc.colorado.edu/publication/charter-revenue>.

⁹¹ *Id.* at 12.

⁹² *Id.* at 7.

charter and district schools, while 200 non-profit EMOs ran more than 2,000 charter schools.⁹³ EMOs now manage between 35-40% of all charter schools.⁹⁴ Because charter schools run by EMOs tend to have larger enrollments than other types of charter schools, it is estimated that they educate 45% of the nation's charter school students.⁹⁵

We believe that there is a principal-agent problem between charter school boards and for-profit EMOs that is similar to the one between securitization trusts and mortgage servicers. As a result of the misalignment of incentives, for-profit EMOs have sometimes acted in a manner that goes against the goals of the charter school boards. Charter school boards have the responsibility, *inter alia*, to ensure that their schools follow all applicable laws and that the schools spend public funds in a fiscally accountable manner.⁹⁶ By contrast, for-profit EMOs have the incentive to increase their revenues or cut expenses in ways that may contradict the goals of charter school boards.

For example, by law, charter schools may not discriminate on the basis of race, religion, disability, or academic potential.⁹⁷ Consequently, charter school boards serve as stewards who ensure that charter schools are, in fact, enrolling all students in a nondiscriminatory fashion. By contrast, for-profit EMOs have the incentive to increase their revenues by not serving students who are considered too “expensive,” such as students with severe disabilities.⁹⁸ The special education population of the Chester Community Charter School, a Pennsylvania charter school operated by for-profit EMO Charter School Management, is illustrative. Pennsylvania charter schools receive special education funding based on the average rate of special education in the

⁹³ *Id.* at 8.

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ 603 Code of Mass. Reg. 1.06, § 1.06 (2015).

⁹⁷ Matthew D. Bernstein, *Whose Choice Are We Talking About: The Exclusion of Students with Disabilities from For-Profit Online Charter Schools*, 16 RICH. J.L. & PUB. INT. 487, 495 (2013).

⁹⁸ Baker & Miron, *supra* note 90, at 19.

host district. The special needs population of the host school district in 2008-09 consisted of 69% of students with mild learning disabilities or speech impairments. By contrast, the special education population for Chester Community Charter School included 92% of mild learning disabilities or speech impairments.⁹⁹ By predominantly educating students with mild disabilities while being reimbursed at the average cost for special education, Chester Community Charter School enhanced revenues by refusing to serve high-need special education students.¹⁰⁰

With respect to fiscal stewardship, charter school boards have the responsibility to ensure that their schools spend market value for the renting of facilities.¹⁰¹ For-profit EMOs have sought to enhance their revenues by charging exorbitant fees for these arrangements.¹⁰² For example, the *Detroit Free Press* reported that the National Heritage Academies (NHA) charged 14 of its schools more than \$1 million in rent each per year.¹⁰³ A *Free Press* review of the 2012-13 audits of more than 50 other charter schools run by other for-profit EMOs revealed that only seven charter schools spent more than \$500,000 in rent. By contrast, all of NHA's schools spent more than \$500,000 in rent.¹⁰⁴ The newspaper also reported that NHA collected \$380 million in rent – including nearly \$42 million in 2013-14 – since the company began running charter schools in 1995.¹⁰⁵

Similar to the mortgage servicer situation, there is evidence to suggest that the regulatory regime in place to guard against for-profit EMO abuse does not address the principal-agent problem. It is presumed that charter school governing boards are exercising control over the

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ Mass. Dep't of Educ., *Charter School Administrative and Governance Guide 3* (Nov. 2007), available at <http://www.doe.mass.edu/charter/governance/adminguide.pdf>.

¹⁰² Baker & Miron, *supra* note 90, at 35.

¹⁰³ Jennifer Dixon, *Michigan's Biggest Charter Operator Charges Big Rents: 14 Schools Pay \$1M*, DETROIT FREE PRESS, Jun. 22, 2014, <http://archive.freep.com/article/20140622/NEWS06/306220106/national-heritage-academies>.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

EMOs; they select the EMOs to run the school and can fire the EMO if the boards are dissatisfied with its performance.¹⁰⁶ Yet, that is not always the case. In some instances EMOs have recruited individuals to serve on charter school boards, who then operated under the false impression that the EMOs were in control of the school.¹⁰⁷

Even when boards try to exercise their duty to oversee their EMOs, their authorizers may thwart them. Such was the case with Detroit Free Enterprise Academy, which was serviced by NHA. While the school was paying \$1 million in rent to NHA, the school had only 33 computers for 715 students.¹⁰⁸ After NHA refused to divulge financial information, the board discussed the possibility of hiring another management firm.¹⁰⁹ However, the *Detroit Free Press* reported that the school's authorizer, Grand Valley State University, intervened on behalf of the private management firm, stating that if the board replaced NHA, the school would lose its charter.¹¹⁰

III. The Predatory Practices Problem

A. Subprime Mortgages

Another issue that has received considerable attention in relation to subprime mortgages relates to the practices used to entice borrowers to enter into those agreements and enhance the profits available. In fact, many have chronicled various “predatory” practices used by mortgage

¹⁰⁶ Baker & Miron, *supra* note 90, at 39.

¹⁰⁷ *Id.* at 39-40.

¹⁰⁸ Jennifer Dixon, *Board Members Say They Got No Support in Fight for Financial Disclosure*, DETROIT FREE PRESS, Jun. 24, 2015, <http://archive.freep.com/article/20140624/NEWS06/306240026/Detroit-enterprise-academy>.

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

originators.¹¹¹ A joint report by the Department of the Treasury and the Department of Housing and Urban Development that pre-dated the financial crisis defined “predatory lending” as “engaging in deception or fraud, manipulating the borrower through aggressive sales tactics, or taking unfair advantage of a borrower’s lack of understanding about loan terms.”¹¹² The National Association of Consumer Advocates noted that predatory practices occurred when “a financial institution takes unfair advantage of a consumer’s financial needs by charging high interest rates and other unconscionable fees and charges.”¹¹³ The group documented specific activities including excessive fees, prepayment penalties, kickbacks to brokers, “loan flipping” (refinancing of loans to generate a fee collected by the lender), bundling unnecessary products with the loan, forced arbitration to restrict availability of legal remedies, steering individuals into risky loans when they qualified for loans with better terms, and specifically targeting vulnerable communities.¹¹⁴

Research concerning predatory practices has demonstrated that “[a]lthough financial institutions preyed on low income, elderly, and minority communities, their efforts were particularly concentrated in communities of color.”¹¹⁵ One study found that “African American borrowers were 6 to 34 percent more likely, and Latino borrowers were 29 to 142 percent more

¹¹¹ See, e.g., Cheryl Wade, *How Predatory Mortgage Lending Changed African American Communities and Families*, 35 HAMLINE LAW REVIEW 437 (2012); Nicole Lutes Fuentes, *Defrauding the American Dream: Predatory Lending in Latino Communities and Reform of California’s Lending Law*, 97 CAL. LAW REV. 1279 (2009); Alexander Bader, *Truly Protecting the Consumer in Light of the Subprime Mortgage Crisis: How Generally Applicable State Consumer Protection Laws Must Be a Tool in Keeping Lending Institutions Honest*, 25 J. OF CIV. RTS. AND ECON. DEV. 767 (2011); Zainab A. Mehkeri, *Predatory Lending: What’s Race Got to Do with It*, 20 PUB. INT. L. REP. 44 (2014); Cheryl L. Wade, *Fiduciary Duty and the Public Interest*, 91 B.U. L. REV. (2011).

¹¹² *Report of the HUD-Treasury Task Force on Predatory Lending* 1 (Jun. 20, 2000), <http://archives.hud.gov/reports/treasrpt.pdf>.

¹¹³ Nat’l Ass’n of Consumer Advocates, *Predatory Lending*, available at <http://www.consumeradvocates.org/issues/predatory-lending>.

¹¹⁴ *Id.*

¹¹⁵ Zainab A. Mehkeri, *Predatory Lending: What’s Race Got to Do with It?*, 20 PUB. INT. L. REP. 44, 47 (2014).

likely to receive a higher rate subprime loan than similarly-situated white borrowers.”¹¹⁶

Targeting communities in this manner is referred to as “reverse redlining.”¹¹⁷

A. Charter Schools

Several charter school critics have likewise begun to use the term “predatory” to describe the actions of those trying to promote charter schools and particularly the profits of for-profit management companies.¹¹⁸ They point to practices that prey on vulnerable parents who lack the political power and financial resources to advocate for change in the existing system. For example, until years of pressure and publicity forced the school to drop the policy,¹¹⁹ Noble Charter School in Chicago not only demanded that its students conform to a strict discipline policy, it fined students who violated the policy.¹²⁰ In another example of taking advantage of vulnerable populations, some Milwaukee charter schools provided gift cards and cash for parents who referred other families to the school.¹²¹ This practice prompted the Milwaukee Common

¹¹⁶ Nicole Lutes Fuentes, *Defrauding the American Dream: Predatory Lending in Latino Communities and Reform of California's Lending Law*, 97 CAL. L. REV. 1279, 1290-1291 (2009) (citing Debbie Gruenstein Bocian et al., Ctr. for Responsible Lending, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages* 3 (2006), http://www.responsiblelending.org/pdfs/r011-Unfair_Lending-0506.pdf).

¹¹⁷ Fuentes, *supra* note 116, at 1287-1289.

¹¹⁸ See, e.g., Nina M. Flores, *As a Teacher, I Fought Predatory For-Profit Charter Schools from the Inside*, WASH. POST, Jul. 21, 2014, <https://www.washingtonpost.com/posteverything/wp/2014/07/23/as-a-teacher-i-fought-predatory-for-profit-schools-from-the-inside/>; Shaun Johnson, *Saving a School: Predatory Enrollment*, @ THE CHALK FACE (July 10, 2014), <http://nepc.colorado.edu/blog/saving-school-predatory-enrollment>; Bertha Lewis, “Success”? *Predatory Education and Subprime Schools*, BLACK STAR NEWS, Nov. 20, 2015, <http://www.blackstarnews.com/education/education/success-predatory-education-and-subprime-schools.html>.

¹¹⁹ Noreen S. Ahmed-Ullah, *Charter School Drops Controversial Discipline Fee*, CHIC. TRIB., Apr. 11, 2014, http://articles.chicagotribune.com/2014-04-11/news/chi-charter-school-drops-controversial-discipline-fee-20140411_1_charter-school-noble-network-student-discipline.

¹²⁰ Noreen S. Ahmed-Ullah, *Chicago's Noble charter School Network Has Tough Discipline Policy*, CHIC. TRIB., Apr. 7, 2014, http://articles.chicagotribune.com/2014-04-07/news/ct-charter-noble-discipline-met-20140407_1_noble-students-charter-chicago-public-schools (reporting that one student was fined \$500 for disciplinary infractions).

¹²¹ Erin Richards, *Crude or Shrewd? School Offers Cash for Student Referrals*, MILWAUKEE J. SENTINEL, Sep. 8, 2014, <http://www.jsonline.com/news/education/crude-or-shrewd-school-offers-cash-for-student-referrals-b99346916z1-274427341.html>.

Council to pass an ordinance prohibiting the practice in 2014.¹²² A Louisiana commentator considers practices used by charter schools to limit the number of low performing and special needs students from enrolling as examples of predatory behavior.¹²³

Reverse redlining, too, has analogous practices associated with charter schools. As explained by one commentator in relation to New York’s charter schools:

New York state government has “redlined” poor school districts for decades, shortchanging them billions even after New York State’s highest court ordered it to make restitution. But instead of granting communities of color the “credit” needed to education children in public school, the predatory equity crowd swooped in with a new option they said would work for us – just like they did with subprime loans...If we allow these same bad actors to continue down the path of expanding charter schools and privatizing public education, then we’re placing the future of our children in the hands of predators.¹²⁴

Policies that take low performing schools, often located in urban areas, and convert them to charter schools can also be viewed as reverse redlining.¹²⁵ Similarly, policies known as parent trigger laws, which permit the conversion of a public school into a charter school when a sufficient number of parents sign a petition to do so, may be a form of reverse redlining. For example, reportedly individuals promoting the conversion of one California school under the

¹²² The ordinance reads: “No charter school shall offer money or any other thing of pecuniary value to a parent, student, teacher, staff member or any other person as an incentive for recruiting a student to enroll at a charter school.” Milwaukee Ord. § 330-26, http://milwaukee.granicus.com/MediaPlayer.php?view_id=2&clip_id=651&meta_id=159040; see also Erin Richards, *Milwaukee Ordinances Quash Cash incentives from Charter Schools*, MILWAUKEE J. SENTINEL (Oct. 14, 2014), available at <http://www.jsonline.com/news/education/milwaukee-ordinances-quash-cash-incentives-from-charter-schools-b99371195z1-279191001.html>.

¹²³ Michael Deshotels, *The Great Predatory Charter School Ripoff*, LA. EDUC., Sep. 1, 2015, <http://louisianaeducator.blogspot.com/2015/09/the-great-predatory-charter-school.html> (listing “predatory” practices such as “location of their school in a more affluent neighborhood, not providing transportation to students, counseling out low performers or other undesirables, [and] ‘no excuses’ discipline policies that dump low performers back to the real public schools.”)

¹²⁴ Lewis, *supra* note 118.

¹²⁵ Amy Froggee & Jill Speering, *ASD Riles Parents, Community with School Takeover*, THE TENNESSEAN, Dec. 22, 2014, <http://www.tennessean.com/story/opinion/contributors/2014/12/22/asd-riles-parents-community-school-takeover/20648199/?from=global&sessionKey=&autologin>; Terence Courtney, *Predation on Public Education*, BLACK ALLIANCE FOR JUST IMMIGRATION, Jul. 1, 2014, <http://blackalliance.org/predation-on-public-education/>; Ingrid Walker Henry *et al.*, *Why We Oppose the Takeover of Milwaukee Public Schools*, MILWAUKEE J. SENTINEL, Sep. 18, 2015, <http://www.jsonline.com/news/opinion/why-we-oppose-the-takeover-of-milwaukes-public-schools-b99579300z1-328199071.html>.

state's parent trigger law engaged in predatory practices that preyed on the poor, largely immigrant population served by the school:

[A] Los Angeles-based group calling itself Parent Revolution organized a local campaign to harass and trick [the parents] into signing petitions that they thought were meant for simple school improvements. In fact those petitions turned out to be part of a sophisticated campaign to convert their children's public school into a privately-run charter — something a majority of parents opposed. At times, locals say, the Parent Revolution volunteers' tactics were so heavy-handed in gathering signatures that they crossed the line into harassment and intimidation. Many parents were misled about what the petition they signed actually meant. Some told me that the intimidation with some of the undocumented Latino residents included bribery and extortion.¹²⁶

IV. What Would a Charter School “Bubble” Look Like?

In this section, we sketch out how a “bubble” would be manifested in the charter school sector. In taking on this task, we realize that the framework used for “economic bubbles,” such as the subprime mortgage crisis does not work for governmental policies, such as charter schools. According to the economic approach, a bubble is defined “as any asset or commodity whose price differs from the ‘fundamental’ value of the asset/commodity.”¹²⁷ This framework is unhelpful for the analysis of governmental policies because, *inter alia*, “it is impossible to assign a value to a policy.”¹²⁸

To determine how governmental policies become bubbles, researchers have developed the concept of “policy bubble.” According to Moshe Maor, a policy bubble is defined as “a real and/or perceived policy overreaction that is reinforced by positive feedback over a long period of

¹²⁶ Yasha Levine, *Pulling the Parent Trigger: The Push to Privatize Public Schools*, TRUTHOUT, May 10, 2013, <http://www.truth-out.org/news/item/16300-pulling-the-trigger>.

¹²⁷ Maor, *supra* note 16, at 472 (internal quotations omitted).

¹²⁸ *Id.*

time.”¹²⁹ Moshe defines a “policy overreaction” as a “policy that imposes objective and/or perceived social costs without producing offsetting objective and/or perceived benefits.”¹³⁰

Maor identifies three phases for a policy bubble: birth, maturity, and death.¹³¹ A policy bubble may form when the emotional idea of a policy corresponds with the mood of a target population.¹³² A policy may grow and mature due to positive feedback, which can come in the form of “herding.”¹³³ Herding occurs when individuals in target groups make choices based on the decisions of other persons in their group.¹³⁴ As a result of these similar choices, the service or public good becomes more available in the locality. Eventually, the policy feedback may have a lock-in effect “whereby the policy becomes institutionalized and grows to self-reinforcement.”¹³⁵ Finally, a bubble may burst when negative feedback replaces positive feedback.¹³⁶ When a bubble does burst, individuals and governmental entities can experience severe losses, occasionally even endangering the sustainability of the policy system.¹³⁷

Applying the policy bubble framework developed by Maor, we conclude that charter school policy bubbles might form in Black, urban communities. Polls have consistently found that Black families are very supportive of charter schools.¹³⁸ Because of their dissatisfaction with traditional public schools, many Black parents want alternative educational options.¹³⁹ Therefore,

¹²⁹ *Id.* at 470.

¹³⁰ *Id.*

¹³¹ Moshe Maor, *Policy Bubbles: What Factors Drive Their Birth Maturity and Death?*, <http://blogs.lse.ac.uk/euoppblog/2014/08/02/policy-bubbles-what-factors-drive-their-birth-maturity-and-death/>.

¹³² Maor, *supra* note 16, at 475.

¹³³ *Id.* at 477.

¹³⁴ *Id.*

¹³⁵ *Id.* at 478.

¹³⁶ *Id.* at 479.

¹³⁷ *Id.*

¹³⁸ Black Alliance for Educ. Options, *A Survey Report on Education Reform, Charter Schools, and the Desire for Parental Choice in the Black Community* (2013), http://scoter.baeo.org/news_multi_media/20130723-Survey%20Report-NEW%5B9%5D.pdf; Black Alliance for Educ. Options, *New Survey Shows Black Voters Strongly Support Parental Choice for Educational Options in Their Communities* (Aug. 2015), http://www.baeo.org/?ns_ref=11&id=7335.

¹³⁹ Black Alliance for Educ. Options, *New Survey*, *supra* note 138.

they may support “permissive” policies associated with charter school growth, such as imposition of multiple authorizers, the removal of charter school caps, and the participation of EMOs, even though Audrye Wong has found that these conditions have a significant negative correlation with academic performance.¹⁴⁰

Policy bubbles may grow in Black, urban communities due to the “herding” phenomenon, which may come in the form of charter school wait lists. As families hear more and more about these waiting lists, they may conclude that charter schools are the best means for them to obtain better educational opportunities for their children. Finally, these policy bubbles could burst as families hear more negative news about the academic performance of charter schools, the inequitable discipline of certain student populations, as well as exposés about financial fraud and the refusal to educate certain types of students on the part of EMOs. There could be a great deal of damage as parents of students attending these charter schools mount legal challenges alleging that the education that they are receiving in these schools violate civil rights guarantees.¹⁴¹

V. What Can Governmental Entities Do To Avert a Charter School Bubble?

State and federal governmental entities can take several steps to avoid the same mistakes in the charter school context that led to the subprime mortgage crisis. If state legislatures decide to empower multiple authorizers, they should enact several provisions in their charter school

¹⁴⁰ Wong, *supra* note 61, at 116.

¹⁴¹ See, e.g., Hillary Hammel, *Charter Schools Break Law and Exclude Vulnerable Students with Illegal Practice, Civil Rights Group Claims*, <http://publicadvocates.org/press-releases/charter-schools-break-law-and-exclude-vulnerable-students-with-illegal-practice-civil>; Elizabeth A. Harris, *Lawsuit Accuses Brooklyn Charter School of Failing to Provide Special Education Services*, N.Y. TIMES, Nov. 5, 2005; Andrew Vanacore, *N.O. School Officials Reach Settlement in Special Education Lawsuit; Monitor to Oversee Reforms*, THE ADVOCATE, Dec. 26, 2014, <http://theadvocate.com/news/neworleans/11137054-148/no-school-officials-reach-settlement>.

statutes to ensure effective screening of charter schools. NACSA has proposed several measures that legislatures could adopt to prevent forum shopping and authorizer hopping, such as: (1) consistent frameworks for measuring charter school performance; (2) consistently high renewal standards that prevent charter schools from hopping to other authorizers once they are threatened with closure; (3) evaluations for prospective authorizers, as well as periodic evaluations of current authorizers; and (4) sanctions for authorizers that have or exercised low standards or have shown a willingness to enable authorizer hopping.¹⁴²

To protect against the principal-agent problem, state legislatures should prohibit any person with a financial relationship with an EMO serving a charter school from serving on the charter school's governing board.¹⁴³ Legislatures should also require training of board members on the best practices for effective governance of charter schools.¹⁴⁴ Charter school legislation should further require authorizers to scrutinize the lease and management agreements between charter school boards and EMOs.¹⁴⁵ Contracts for management services should be made to be available to the public, with detailed information about the services provided by EMOs.¹⁴⁶ Moreover, authorizers should require EMOs to provide full financial disclosure of the expenditures and profits related to each school that they serve.¹⁴⁷ In addition, to guard against predatory charter school practices, authorizers should prohibit practices that take advantage of

¹⁴² Nat'l Ass'n of Charter School Authorizers, *On the Road to Better Accountability: An Analysis of State Charter School Policies* 59 (2015), <http://www.qualitycharters.org/wp-content/uploads/2015/08/State-Policy-Analysis.pdf>.

¹⁴³ Annenberg Institute for Sch. Reform, *Public Accountability for Charter Schools: Standards and Policy Recommendations for Effective Oversight* 6 (2014), <http://annenberginstitute.org/sites/default/files/CharterAccountabilityStds.pdf>.

¹⁴⁴ Conn. State Dep't of Educ., *Fact Sheet: Improvements to the State Department of Education Oversight of Charter Schools* (Jul. 9, 2014), http://www.sde.ct.gov/sde/lib/sde/PDF/PressRoom/Fact_Sheet_Improvements_to_State_Department_of_Education_Oversight_of_Charter_Schools.pdf.

¹⁴⁵ Baker & Miron, *supra* note 90, at 44-45.

¹⁴⁶ Annenberg Institute for Sch. Reform, *supra* note 143, at 6.

¹⁴⁷ *Id.*

vulnerable populations, such as fining parents for discipline infractions, and prohibiting low-performing and special needs students from enrolling in charter schools.¹⁴⁸

Finally, the federal government must use its funding incentive programs to encourage high-quality authorization standards. According to the Center for Media and Democracy, the federal government has spent more than \$3.3 billion since 1995 to promote charter school expansion.¹⁴⁹ However, a review of the documentation surrounding these funding efforts revealed that the U.S. Department of Education “has knowingly awarded charter grants to states with no statutory oversight of charter schools as the grant applications are evaluated on how much ‘flexibility’ from state laws charter schools enjoy.”¹⁵⁰

In September 2015, the U.S. Department of Education continued this trend with its \$157 million grant program designed to replicate and expand high-quality charter schools. This agency awarded \$71 million to the Ohio Department of Education (ODE), even though the state’s charter schools had become a “joke” due to the sector’s myriad scandals.¹⁵¹ The state’s authorizer system, which allowed higher education institutions and nonprofit entities to serve as authorizers, also received its share of criticism. NACSA reported that several authorizers had sold management services amounting to “tens of thousands each year” to their schools, and that several schools that had been closed by one authorizer were able to re-open as “new” schools under other authorizers (i.e. “authorizer hopping”).¹⁵² Moreover, the state’s effort to reform its

¹⁴⁸ See Michael Kreamer, “Predatory” Charter Schools Not True to Their Purpose, THE ADVERTISER, Oct. 2, 2014, <http://www.theadvertiser.com/story/opinion/2014/10/02/predatory-charter-schools-true-purpose/16613293/>.

¹⁴⁹ Jonas Persson, *New Documents Show How Taxpayer Money Is Wasted by Charter Schools – Stringent Controls Urgently Needed as Charter Funding Faces Huge Increases* (May 8, 2015), http://www.prwatch.org/files/5-8-15_final_cmd_reporters_guide_on_charter_waste_and_lack_of_accountability.pdf.

¹⁵⁰ Jonas Persson, *Special Report: Feds Spent \$3.3 Billion Fueling Charter Schools but No One Knows What It’s Really Bought* (May 7, 2015), <http://www.prwatch.org/news/2015/04/12799/new-documents-show-how-federal-taxpayer-money-wasted-charter-schools>.

¹⁵¹ Valerie Strauss, *Feds Didn’t Carefully Monitor \$3 Billion It Gave for Charters – and It Just Awarded \$157 Million More*, WASH. POST, Oct. 1, 2015.

¹⁵² Nat’l Ass’n of Charter Sch. Authorizers, *Authorizer Hopping*, *supra* note 70, at 2-3.

charter school authorizing system, which created a ranking system of charter school authorizers, was criticized for failing to penalize authorizers for the poor academic performance of their schools.¹⁵³ In light of this disparagement, the U.S. Department of Education in November 2015 requested additional information from ODE about its charter authorization system in order to receive the grant award.¹⁵⁴ ODE was required to provide in its response: (1) “[a]ny additional systems to ensure the integrity of charter school and charter school authorizer data and evaluation”; and (2) “[a]ny additional reporting procedures that will facilitate a transparent charter school authorizer and charter school review process.”¹⁵⁵ We hope that the federal government continues down this path by including authorizer accountability criteria as a condition for charter school funding in the future.

Conclusion

As state and federal policymakers ponder over the wisdom of increasing the number of charter schools, they should pay attention to the lessons provided by the subprime mortgage crisis. According to several analysts, the creation of an alternate granting structure helped to create that debacle by removing the risk of mortgage default, while also removing the incentive to conduct careful screenings of mortgages. The alternate granting structure also created a principal-agent problem between mortgage investors and servicers that the legal structures were poorly equipped to counter. Finally, many charter schools are engaging in predatory practices that are similar to the subprime mortgage crisis. We fear that charter school advocates may be

¹⁵³ Patrick O'Donnell, *Ohio Ignores Online School F's As It Evaluate Charter School Overseers*, CLEVELAND PLAIN DEALER, June 14, 2015.

¹⁵⁴ U.S. Dep't of Educ., Letter Re: Charter School Program: Grant Award No. U282A150023 (Nov. 4, 2015), available at <https://assets.documentcloud.org/documents/2504681/letter-from-the-u-s-education-department-placing.pdf>.

¹⁵⁵ *Id.* at 2.

inadvertently making the same mistakes in their attempts to create more charter schools. If state and federal policymakers are not careful, they could create a charter school bubble in Black, urban communities that could eventually burst. Therefore, policymakers should put safeguards in place to prevent this undesirable event from occurring.