

# Imagine schools' real estate deals fuel company growth

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**ST. LOUIS** • When students first entered Imagine Academy of Academic Success four years ago, their school was already entangled in a complex series of real estate deals — ones that would divert dollars from their education.

By the time they were on their first summer break, their brown brick building at 1409 East Linton Avenue had been sold three times, the final price nearly 10 times higher than the first. In the process, the company running the school — along with a small group of other players — cashed in.

Imagine Schools Inc., the nation's largest charter school operator, runs six charter schools in St. Louis. Together, their performance on state standardized exams is worse than any school district in Missouri.

Nevertheless, those schools are generating millions of dollars for Imagine and a Kansas City-based real estate investment company through real estate arrangements ultimately supported with public education money.

The deals are part of a strategy that has fueled Imagine's national expansion. In most cases, Imagine sells its buildings to another company that leases them back to Imagine, with the schools themselves shouldering the rent with public funds.

It's a strategy that includes risk. In St. Louis, it has led to one deal gone sour. It has saddled the schools with lease payments that cost more per student than any other charter school in the city. It has led to land purchases on speculation that a school might open.

In downtown St. Louis, it has pushed a school to open in 21 days, while other charter school organizers would take a year or more to prepare. And it has contributed to budget shortfalls at the schools.

Leaders of Imagine Schools Inc., a for-profit charter school management company based in Virginia, say their schools answer the desperate demand for alternatives to failing traditional public schools. They defend their unusual business model as an effective means to meet that demand.

"I think of it as another approach to serving parents of kids and providing a choice to parents who might not otherwise have it," said Barry Sharp, Imagine's chief financial officer.

Imagine officials generally discount their schools' low test scores and point to other indicators of success. Namely, they say, Imagine schools in St. Louis have been popular with parents, drawing 3,800 students this fall — more than 10 percent of those who attend public schools in the city.

"We provide an environment that is warm, an environment that is stimulating, and an environment where there is learning," said Sam Howard, executive vice president for Imagine.

But the Post-Dispatch has found problems at Imagine schools that run far deeper than its low test scores.

Interviews with dozens of parents and educators and review of hundreds of pages of documents related to Imagine's real estate suggest that Imagine's charter schools here have failed students, even as the schools have been structured to support the company's financial success.

The investigation shows the schools have exceeded occupancy limits and were cited for building code violations, including for an inoperable fire alarm, days before opening in 2007. Along the way, Imagine has worked with a real estate investor who pleaded guilty in February to bank fraud for a kickback scheme involving unrelated downtown real estate.

Documents also point to unexplained wire transfers referencing the name of an Imagine executive that were made by the same developer. (See [accompanying story](#).)

In addition to rent, Imagine's charter schools are required to pay the for-profit company 12 percent of their budget each year. Yet some classrooms in Imagine schools lacked basic instructional materials— such as age- and grade-appropriate books, pencils, paper and other supplies — when Missouri Baptist University, the sponsor of Imagine schools, recently evaluated them. Former teachers and parents also describe schools that cut corners even as children fall further behind.

"There are shortages of basic things like toilet paper, soap, paper towels," said Serena Mouyaga, who taught Spanish for two years at Academic Success.

Angela Howard, a former principal at the school for four years, said educating children — most of whom live in poverty and are several grade levels behind their peers — was difficult given budgetary constraints.

"You have a significant amount of children who have asthma, who have bipolar, who are diagnosed with ADHD, and you have limited funds to meet those needs," she said.

## A DIFFERENT STRATEGY

As far as brands go, Imagine dominates the charter school industry. Its schools enroll more than 36,000 students at 75 schools in 13 states and the District of Columbia.

The company was formed in 2004, after Dennis W. Bakke retired as chief executive of AES Corp., a global energy supplier. He and his wife, Eileen, used part of their fortune to buy the failed Chancellor Beacon charter school company.

The Bakkes infused Imagine Schools Inc. with \$150 million of their own capital to build what would become the largest commercial charter school operator in the country. According to Imagine's 2010 annual report, revenue grew to \$265 million from \$95 million in 2006.

Charter school management companies such as Imagine are intended to bring greater efficiency and support to schools by centralizing curriculum decisions and administration. But the fees they charge their schools and how they make decisions range widely.

Imagine's approach contrasts with that of most other charter schools.

Imagine schools open big, while other charter schools typically open with a few grades and then grow. For example, in 2007 Imagine opened four campuses in St. Louis for 1,663 students in kindergarten through eighth grade. In contrast, the independent City Garden Montessori opened the next year north of Tower Grove Park with just 52 pupils in kindergarten through third grade.

"They just seem to be opening up a large number of schools in a short period of time," said Todd Ziebarth, vice president of state advocacy and support for the National Alliance of Public Charter Schools. "Not to say you can't do that and have high-quality schools. Schools that grow slow tend to perform better in the short and long term. That's kind of anecdotal, but that's what we've seen."

Critics say Imagine's focus on growth compromises how charter schools should be governed. Under Missouri law, charter schools are overseen by independent boards. Those boards, in turn, often hire companies to administer the schools. But Imagine executives operate in reverse, recruiting board members themselves.

"We don't see the boards in charge, we see the management company in charge," said Robbyn Wahby, education liaison for St. Louis Mayor Francis Slay. "That is a significant difference that we think has led to some of the poor outcomes."

Former staff members say the company places a greater emphasis on enrollment than on academics.

In March, Angela Howard said, she would begin receiving emails from the regional office pressuring her to raise enrollment numbers for the next school year. This took her focus off state standardized tests, which few of her students were passing.

"Our test scores were horrible," she said.

## COMPLEX DEALINGS

One of the greatest struggles in opening a charter school is finding a suitable building and the money needed to make it a school.

It's a struggle Imagine's business model is built to address.

Just like traditional public schools, charter schools rely on state money to operate. But they receive no state or local funding specifically for buildings and renovations. So every dollar spent on construction or leases is diverted from instruction.

"A new public school can be built on the bond credit of the city. That's not available to charters," said Sharp, who is also the president of Imagine's real estate arm. "To build a school or open a school or refurbish a building like we've done in St. Louis, that's difficult."

Charter school organizers in St. Louis most often lease buildings — such as old warehouses or vacant Catholic schools — and then take out a loan to renovate them.

But Imagine offers a far more complex solution, engaging in a series of transactions that leave future charter schools predestined to have high rent even before they open.

In St. Louis, a common link between those transactions is Samuel Glasser, a developer who recently pleaded guilty to federal bank fraud charges involving a project unrelated to Imagine schools.

For more than a decade, Glasser made his mark downtown by turning pieces of Washington Avenue into a district filled with loft apartments and condominiums.

In 2003, Glasser leased part of the International Shoe Co. building at 1509 Washington Avenue to the now-defunct Ethel Hedgeman Lyle Academy. The school was operated by Chancellor Beacon, the company Imagine would later buy.

And it would be the first in a chain of transactions that would place Glasser at the forefront of Imagine's expansion in St. Louis.

Glasser did not respond to repeated requests for comment. But Imagine officials say he was part of the team that selected sites for future schools. He

bought or arranged the purchases of existing buildings using such names as Stanley H.D. Equities, 3740 Marine Associates and 1901 North Kingshighway.

Two of the buildings — the old King Tri-A and Lowell schools — had belonged to St. Louis Public Schools, which resisted selling property to charter organizers.

To get around this policy, Glasser didn't state his true plans on the sales agreements. After the two buildings opened as Imagine charter schools, district officials temporarily imposed deed restrictions on their buildings to prevent such moves.

Glasser later sold the two buildings to a subsidiary of Imagine Schools — Schoolhouse Finance — at mark-ups of as much as \$665,000.

He profited in other ways. Schoolhouse Finance reimbursed his general contracting company, Samuel & Co., for work done on four of the school sites according to contracts, Sharp said. In addition, Samuel & Co. earned profits and fees for each project. In the case of Imagine Academy of Careers Middle, the company made \$943,244 in construction fees and profit from the \$2.4 million project, according to an audit filed with the Missouri Department of Economic Development.

In 2007, the department awarded Glasser \$478,583 in historic tax credits for work done on the building that houses Imagine Academy of Academic Success. Glasser charged Imagine \$150,000 to apply for those credits, according to a development agreement. And he charged the company similar fees for each of three additional applications he submitted to get historic tax credits on other Imagine school buildings.

## **BIG INVESTMENTS**

Imagine can traffic in such high-dollar transactions thanks in part to a relationship with a key investment partner. And like the relationship with Glasser, it's one that leads to escalating costs for schools.

In 2007, a real estate investment trust founded by Joseph E. Robert Jr., an advocate for school choice, began infusing Imagine with the capital it needed to buy and renovate buildings across the country.

That trust, called JERIT CS Fund I, is now a subsidiary of Kansas City-based Entertainment Properties Trust, which mostly owns multi-plex theaters, wineries and small ski resorts nationwide. Holdings include Hidden Valley in Wildwood, as well as 26 Imagine school buildings in nine states and Washington. Five of the schools are in St. Louis.

The company buys the school buildings from Schoolhouse Finance and leases them back to Schoolhouse. Schoolhouse Finance then subleases the buildings to the charter schools, who get money from the state based on attendance and enrollment. Schoolhouse charges the schools 5 percent to 15 percent more for rent than what it passes on to Entertainment Properties Trust, Sharp said. Imagine spends this difference on property taxes and on rent if a school closes, he said.

In 2010, Entertainment Properties Trust collected \$26.3 million from its leases with Imagine schools, according to an end-of-year financial statement. Within 30 years, the company plans to triple its investment on each school building.

"If you do it right, it can be a steady investment income," said Jerry Earnest, chief investment officer for Entertainment Properties. "If the schools do well academically and do provide good opportunity for kids, the schools will operate for a long period of time and be a good investment."

In June 2008, Entertainment Properties bought the building used by Academic Success on East Linton Avenue for \$4.7 million — almost 10 times what Glasser had paid for the structure in 2006. The company paid Schoolhouse Finance \$11.5 million for Imagine College Prep at 706 North Jefferson, 10 times what Imagine had paid for the building. It also paid \$22.8 million for the building at 1008 Spring Avenue, a former Kroger bakery now used by Imagine Academy of Environmental Science and Math.

Imagine pours millions of dollars into these buildings, filling empty shells with shiny lockers, bright hallways and sunlit classrooms. Sharp said the escalating prices of the transactions merely reflected the renovation costs. In some cases, Imagine lost money on the sales, he said.

Nevertheless, within months of the sales, the boards that oversee those schools approved amended leases with higher rents than the schools had paid to Imagine the year before.

All six Imagine charter schools in St. Louis are paying a higher percentage of their budgets toward rent or mortgages than any other charter school in the city. For example, the three schools that operate under the Imagine Academy of Careers charter spent almost 21 percent of their revenue on rent in the 2009-10 school year. In contrast, City Garden Montessori spent less than 4 percent of its revenue that year to rent part of Tyler Place Presbyterian Church on South Spring Avenue.

Imagine officials stand by their real estate strategy, saying it produces a respectable environment for its schoolchildren.

"You want to treat them like first-class citizens," said Sam Howard, executive vice president for Imagine, and no relation to Angela Howard.

They say the arrangement is not designed to enrich Imagine. In fact, Sharp says Imagine bears the brunt of the financial risk when a charter school closes, as recently happened in Marietta, Ga. In that case, Sharp said, Imagine was left to pay the rent on a school that no longer exists.

But the company recently found a way to turn a similar situation in its favor in St. Louis.

Last year, Ethel Hedgeman Lyle Academy, once an Imagine school, closed because of financial failure.

In August, Imagine opened another school in its place. Imagine Academy of Cultural Arts now serves kindergarten through fifth grade at 1509 Washington Avenue.

"And the underlying real estate never lost a beat," said Greg Silvers, chief operating officer for Entertainment Properties, in a June teleconference with investors.

## **VIOLATIONS**

Imagine's complex real estate transactions produce top-notch school buildings, company officials say. They proudly lead visitors through Imagine Academy of Environmental Science and Math, a school on South Spring Avenue that spent \$2.4 million on rent last school year, according to a school budget.

Museum-quality nature exhibits line the hallways. Several murals were painted by a professional artist.

"I've got to give it to Imagine," said Rep. Tishaura Jones, D-St. Louis. "I've toured a couple of their schools and they're beautiful facilities. ... You walk in, and it leaves you to believe there is learning here."

But public records point to numerous shortcomings at several other Imagine campuses.

In 2007, two weeks before school started, city building inspectors declared Imagine Academy of Academic Success unsafe for occupancy. They found 13 mechanical code violations, ranging from fuel-burning equipment installed without a permit, to a heating system that didn't supply adequate heat for winter, according to city inspection records.

The fire alarm was inoperable, a letter from the fire marshal said. Exit signs didn't illuminate. The sprinkler system wouldn't function.

Frank Oswald, head of the city's Building Division, said that the list of issues was addressed in the days before school started and that Imagine had verbal permission to use the building. However, a letter from the city to Glasser, the building's owner, several weeks later stated otherwise.

It wasn't until Nov. 7 — almost three months after children first sat at their desks — that the city's Building Division gave the school the permit legally needed for occupancy.

Year after year, Imagine violates city safety codes by putting more children in two of its school buildings than the city considers safe. Inspectors set occupancy limits based on the number of exits and how long it would take students to leave the building in an emergency.

"We take those pretty seriously," said Rich Voelker, who supervises fire safety for the Building Division. "Those should be adhered to."

The limit for Academic Success is 400 students, according to a 2007 letter from the city's Board of Public Service. Yet Imagine's enrollment target for the school is 600. According to state data, the school has enrolled 405 to 505 children since it opened.

Imagine Academy of Careers Middle School, 1409 North Kingshighway, has an enrollment limit of 300 students, says a permit on file with the city. Yet the school enrolled 333 children in fall 2008, and 331 children in fall 2009, according to the state.

"I don't know what that's all about," Sam Howard said. "We follow the building code and city procedures."

## **TIGHT BUDGETS**

By the end of its first school year, Academic Success was losing money.

It was running a deficit of \$246,000, according to minutes from the May 2008 board meeting.

Budget constraints were being felt across town at all Imagine schools. According to state financial reports, Imagine schools finished their first year with operating deficits and continue to have negative fund balances.

In addition to rent, Imagine charges schools operating costs, which amount to 12 percent of their annual revenue. The company also charges fees to cover salaries of regional administrators. It charges schools a one-time "development fee" of \$250,000 to cover start-up costs. When schools don't make budget, Imagine lends the schools money with interest.

In November 2008, after one year of operation, Imagine Academy of Environmental Science and Math laid off 17 teachers and staff members, according to minutes from that month's board meeting. The building had just been sold to Entertainment Properties. Annual rent was about to increase to \$2.3 million, from about \$2 million.

"The lease will always be a liability," Lavon Bush, Imagine's regional chief financial officer, said at the November 2008 board meeting.

As the schools struggled financially, Imagine's Schoolhouse Finance spent more than \$4.3 million buying a city block at 4230 Gravois Avenue, according to city records. The property includes an eight-story building once used as a candy factory. Architectural renderings show Imagine's plans to turn it into a performing arts school for elementary, middle and high school students. A regulation-sized soccer field was included.

Imagine is no longer pursuing that option.

"We've written off our investment," Sharp said.

Teachers at Imagine schools say they know very little about the company's real estate ventures. They do know, however, that they have limited supplies and often get no more than two reams of paper a month. Their average salaries in 2010 were between \$35,000 and \$37,000 — compared with almost \$50,000 in the St. Louis Public Schools.

Teacher turnover is a problem. At Academic Success, just 15 of 41 teachers in 2009-10 returned for the 2010-11 school year, according to a report from Missouri Baptist University, sponsor of the Imagine schools.

Angela Howard said she could no longer work for Imagine. She wanted to pay her best teachers more money, she said. The budgetary stresses, among other things, were too much.

Test results show that in 2011, just 5.4 percent of the school's students passed the communication arts section of the state test, and 8.5 percent passed the math portion.

"It was the frustration of the whole setup," Howard said. "To me, the red flag should be your test scores and how they're worse than every other school in the state of Missouri. If that is not a red flag I don't know what is."

*David Hunn of the Post-Dispatch contributed to this report.*