

Selecting the Best Facility Financing for Your Charter School

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Presentation Outline

- **Structures: Options for Charter Schools**
- **Investors & Lenders to Charter Schools**
- **Key Factors When Considering a Facilities Financing**
- **Financing Options in Today's Market**
- **Combining Financing Methods**
- **Q & A**

Structures: Options for Charter Schools

- **Structures for Acquiring & Financing Facilities**
 - Facilities Development Entity
 - Charter Management Organization
 - Captive Development Entity

- **Financing vehicles**
 - Loans
 - Other local options
 - Bonds

Charter School & Facilities Development Entity

- **Charter school needs facilities**
- **Utilizes a facilities development entity**
 - Nonprofit/tax exempt (affiliated or 3rd party)
 - Expertise in real property acquisition, development and rehabilitation
 - Obtains financing
 - Leases facilities to charter school

Charter School & Charter Management Organization

- **Charter school needs facilities**
- **Utilizes its charter management organization**
 - Nonprofit and tax-exempt
 - Obtains financing
 - Contracts with builder/developer/contractor to develop and/or improve or rehab facilities
 - Leases facilities to charter school

Charter School & Captive Property Development Entity

- **Charter school needs facilities**
- **Forms its own property development entity**
 - Limited liability company (LLC)
 - Supporting organization is sole member
 - LLC disregarded for federal tax purposes
 - LLC obtains California tax-exempt status as title holding company
 - LLC obtains financing
 - Contracts with builder/developer/contractor to develop and/or improve or rehab facilities
 - Leases facilities to charter school

Investors and Lenders to Charter Schools

Money is Harder to Come By



- The number of lenders is decreasing
- Lenders are toughening standards
- Leverage is being taken out of financial system
- Lenders want to see strong academic results, not just weak competition

Challenges in Finding Sources of Capital

Investors See Risk

- ➔ **Charter can be revoked**
- ➔ **No Extra Facility Funding for Charters**
 - *Investors repaid from operational funding*
- ➔ **Revenues are Dependent on Enrollment**
 - *Versus school district with ad valorem tax as revenue source*
- ➔ **Little to No Equity in the Project**
- ➔ **Charter Schools are “Illiquid” Investments**
 - *Some exceptions for tax-exempt bonds*



Who Lends to Charters?

Cash Flow Lenders

*Little focus on loan to value or equity
Invest in the operational risks of charter schools*

Tax-Exempt and Taxable Bond Investors

**Bond Funds, Insurance Companies,
Money Managers**

Tax-exempt

- ✓ Very broad and deep source of funding
- ✓ Infrastructure for investing fully developed
- ✓ Require well established and performing schools (3+ year of history)

Taxable

- ✓ Somewhat limited but developing funding sources
- ✓ Larger issues (\$50+ million) will see more investor demand
- ✓ Preference for longer operating history (5+ years)

Mission Driven Lenders & Community Development Financial Institutions (“CDFIs”)

La Raza, LIIF, LISC, NCB

- ✓ Investing “infrastructure” fully developed
- ✓ Can invest in “younger” schools if aligned with organizational missions
- ✓ Increased lending standards and/or have faced loss of funding

Who Lends to Charters?

Other Lending Sources

*Make minimal investments in charter school operational risk
Not as cash-flow oriented; less concerned with understanding your school
More concerned with value and/or use of real estate
Federal subsidy can be important credit factor in loan decision*

Commercial Banks

- ✓ Loan-to-value a key consideration
- ✓ Typically need guarantees and/or equity
- ✓ Historically, not a reliable or scalable source of funding
- ✓ Can provide short-term or interim funding solutions

Tax-Credit Investors

- ✓ Need Taxable income to offset tax liability
- ✓ Guarantees or credit enhancement required for some investors

Key Factors When Considering a Facilities Financing

Key Factors to Consider...

EXIT STRATEGY

Is Financing Permanent?

- Fully amortized by maturity?
- Tax-exempt bonds are typically fully amortized
- QSCBs can be fully amortized depending on structure
- NMTCs not fully amortized at maturity

Is There Refinance Risk?

- If not fully amortized, loan will need to be refinanced at maturity
- Interest rate risk associated with refinancing
- Do you have the option to refinance?
- Are you building equity or does the entire loan need to be refinanced?



Key Factors to Consider...

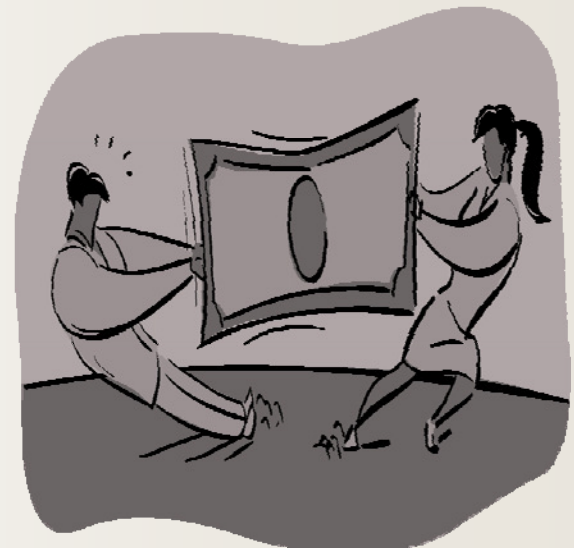
% OF BUDGET GOING TO FACILITIES COST

**Maximum of 20% of your steady-state budget
(now or at future full enrollment)**

→ 15% or less is ideal

Example: \$8 Million Budget

→ Debt Service no more than \$1.6 million annually, \$1.2 million preferable

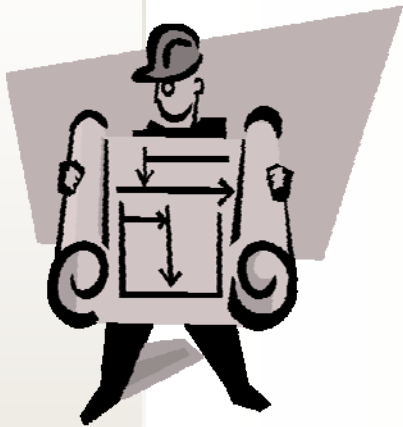


Key Factors to Consider...

ABILITY TO FINANCE EXPANSION OF SCHOOL

Think Long Term: Future Capital Plans

- **Facility financing will have “first lien” on revenues**
 - *Few (if any) subordinate sources to fund expansion*
- **Some types of financings will not allow “parity” debt in future**
 - *Parity means having equal claim on revenues and facilities*
 - *You want as much flexibility as possible to issue parity debt in the future*
- **Future capital plans should be considered when evaluating financing options today**



Key Factors to Consider...

ABILITY TO PREPAY

Ability to pre-pay will depend upon financing vehicle and negotiated terms



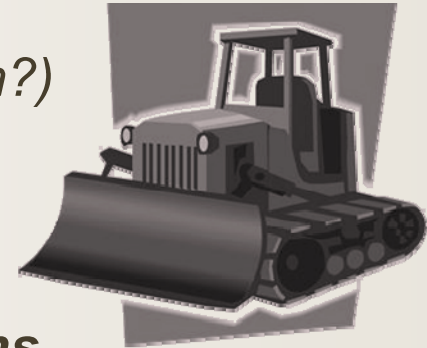
- ➔ **Tax-exempt bonds can be called prior to maturity at the school's option**
 - *10-year par call is standard*
- ➔ **New Markets Tax Credits, other Federal programs involving credits**
 - *Typically cannot be pre-paid prior to maturity*
 - *Equity investors can face penalties if loans are prepaid*
- ➔ **Qualified School Construction Bonds**
 - *"Direct-Pay" QSCBs typically have 10-year par call*

Key Factors to Consider...

REAL ESTATE ISSUES

Deal with Real Estate issues **EARLY!**

- ✓ *Deed(s) on all properties - fee simple or leasehold*
- ✓ *Title insurance*
- ✓ *Existing surveys (land division? combination?)*
- ✓ *Environmental site assessments*
- ✓ *Geotechnical reports*
- ✓ *Preliminary plans*
- ✓ *Zoning ordinances and building restrictions*
- ✓ *Property tax information*
- ✓ *Access, utilities, and other municipal services*
- ✓ **GET ALL NECESSARY APPROVALS**



Financing Options in Today's Market

Financing Options

TAX-EXEMPT BONDS

- ➔ **100% Financing: No loan-to-value requirements**
- ➔ **Permanent Financing – No refinance risk**
 - *Amortization of 30 -35 years, or more*
 - *Option to refinance if economically advantageous*
- ➔ **Investor base the most developed of any funding source**
- ➔ **Most flexible regarding the “Key Factors” discussed earlier** (no exit strategy needed, can finance expansion, etc.)
- ➔ **In certain situations, can be combined with other tax-preferred structures**
- ➔ **Lowest execution risk**

Financing Options

TAX-EXEMPT BONDS (cont.)

- ➔ **No geographical, demographic or use of proceeds restrictions**
 - *Only requirement is proceeds are for capital projects*
- ➔ **Debt Service Reserve Fund = 1 Year of Debt Service**
 - *Funded with bond proceeds*
 - *Used to pay investors if payment not made by school*
 - *Used to make final year's payment*
- ➔ **Market requires experienced schools**
 - *3-year operating history, or*
 - *If not, support from more experienced schools*
- ➔ **Post credit-crisis, investors scrutinize academic quality and achievement more rigorously**

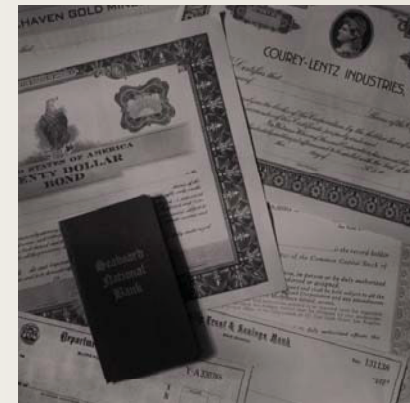
Financing Options

TAX-EXEMPT BONDS (cont.)

↳ What Can be Financed with Bonds?

- ✓ Construction
- ✓ Renovation
- ✓ Acquisition
- ✓ Refinancing
- ✓ Financing costs:

↳ Must be a Non-Profit 501(c)(3) or Governmental Unit



Financing Options

TAX-EXEMPT BONDS (cont.)

How Bond Proceeds are Used

Sources

Bond Proceeds	\$10,000,000
Other Sources (if any)	0
Total	\$10,000,000

Uses

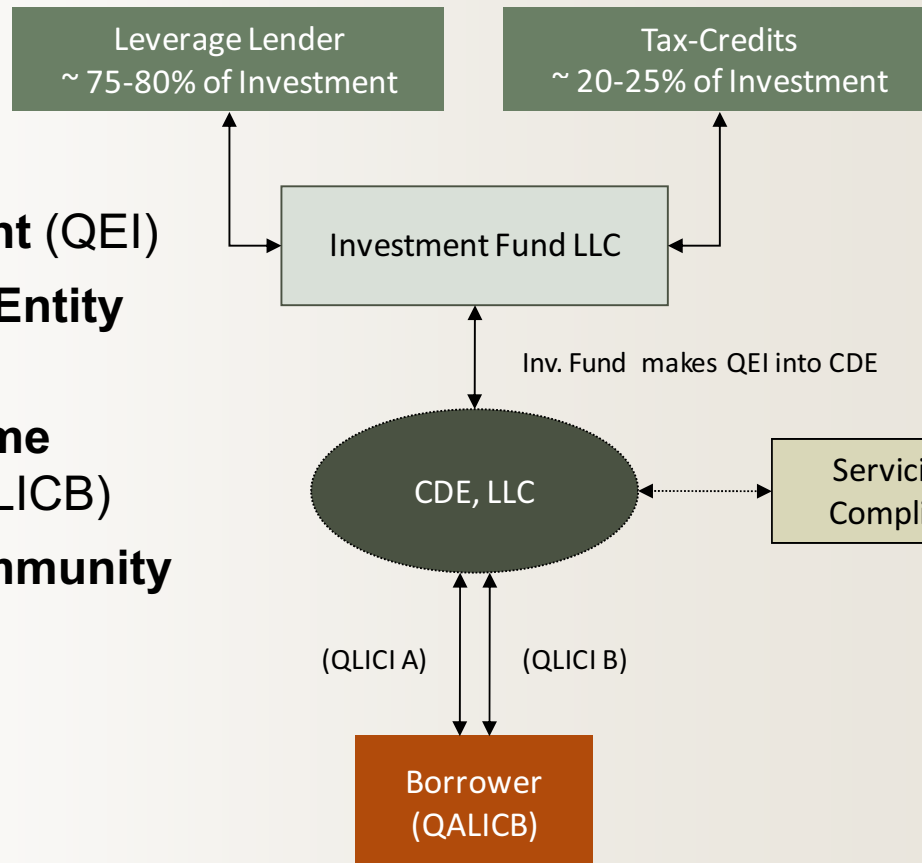
Project	\$8,770,000
Debt Service Reserve Fund*	730,000
Costs of Issuance	500,000
Capitalized Interest (if any)	0
Total	\$10,000,000

* Can be used to make final year bond payment
Interest income accrues to school

Financing Options

NEW MARKETS TAX CREDITS

Standard Leverage Model ➔



Key Terms

- ➔ **Qualified Equity Investment (QEI)**
- ➔ **Community Development Entity (CDE)**
- ➔ **Qualified Active Low Income Community Business (QALICB)**
- ➔ **Qualified Low Income Community Investment (QLICI)**

Financing Options

NEW MARKETS TAX CREDITS (cont.)

- ➔ **Flexible Uses:** Acquisition, Construction, Refinance, Costs
 - *Some capitalized interest can be financed*
- ➔ **Uses combination of senior AND subordinate debt**
 - *Senior debt is a “leveraged loan”*
 - *Subordinate debt is funded from tax-credits, becomes “equity”*
- ➔ **High loan to value** for senior debt – “equity” from Tax-Credits
 - *Can be difficult to find leveraged loans in today’s market*
- ➔ **Borrower will accrue equity equal to subordinate debt at end of financing period of 7 years**
 - *One of the main reasons NMTCs are attractive financing tools*

Financing Options

NEW MARKETS TAX CREDITS (cont.)

→ **Low Debt Service Requirement:**

- *For most structures, interest only for life of financing (7 years); easy on your budget*
- *There are lenders which require setting aside principal; total payments similar to tax-exempt bonds*
- *Equity accrual results in substantial debt “forgiveness” (20-25%); though not for “revolving allocations”*

→ **Higher Execution Risk:**

- *Need time to find allocation*

Financing Options

NEW MARKETS TAX CREDITS (cont.)

- ➔ **Geographic Restriction** - Facility is in census tract with:
 - **Distressed**: *At least 20% poverty rate or median income up to 80% of area or statewide median*
 - **Highly Distressed**: *At least 30% poverty rate or median income up to 60% of area or statewide median or unemployment rate of 1.5 times the national federal average*
- ➔ **Targeted populations** test if census tract does not meet above
- ➔ **If you're not in an eligible area or don't serve a targeted population, you can't use NMTCs**
 - *No other financing options have these restrictions*

Financing Options

NEW MARKETS TAX CREDITS (cont.)

- ➔ **Must Purchase Allocation** from an “Allocatee”
 - *Allocatee receives NMTC allocation from CDFI Fund of US Treasury Dept. through an RFP process*

- ➔ **Must Find a “Leveraged Lender”**
 - *Tax-exempt bonds, mission-driven CDFI’s, Banks, QSCBs*
 - *Source of these affects Exit Strategy, Ability to Expand*

- ➔ **Restrictions on Ability to Prepay** prior to 7 year maturity
 - *Tax-credit investors face penalties if loan prepaid*
 - *Tax-credit investors typically require lenders to forbear against collateral during compliance period*

Financing Options

NEW MARKETS TAX CREDITS (cont.)

- ➔ **Refinance risk for typical leveraged model**
 - *Balloon in year 7 for +/- 80% of loan after “debt forgiveness” (Unless tax-exempt bonds funded leveraged loan)*
- ➔ **Not subject to “Davis-Bacon” prevailing wage requirements**
 - *An advantage over QSCBs*
- ➔ **Can be combined with other tax-advantaged sources**
 - *Tax-exempt bonds might be possible leveraged loan source*
 - *“Tax Credit” QSCBs (if modified)*

Financing Options

QUALIFIED SCHOOL CONSTRUCTION BONDS (cont.)

TAX CREDIT OPTION

- Created by American Recovery & Reinvestment Act of 2009
- Buyer receives income from claiming tax credits (plus possible “supplemental coupon”)

DIRECT PAY OPTION

- Created by “Hire Act” of 2010
- Buyer receives taxable interest
- Borrower receives subsidy from federal government equal to “tax credit” rate

Common Elements

100 % of proceeds must be used for construction, rehabilitation or repair; cannot be used to refinance long-term debt

If a school hasn't already received allocation or has applied and is on waiting list for unused allocations, QSCBs not available.

Financing Options

QUALIFIED SCHOOL CONSTRUCTION BONDS (cont.)

TAX CREDIT OPTION

DIRECT PAY OPTION

Common Elements

Medium execution risk

Do not have to be in “eligible” area; advantage over NMTCs

“Davis-Bacon” prevailing wage compliance provisions

Tax Credit rate set daily; 5.23% as of 2/28/2011

<https://www.treasurydirect.gov/GA-SL/SLGS/selectQTCDDate.htm>

**Maximum maturity set monthly; has ranged from 15-19 years
(also on website above)**

Financing Options

QUALIFIED SCHOOL CONSTRUCTION BONDS (cont.)

TAX CREDIT OPTION

DIRECT PAY OPTION



Investors receive tax credit instead of interest

- *Must be a taxable investor*
- *Excludes tax-exempt buyers*
- *Yield mainly a function of price paid for tax credits, can include supplemental coupon*

Banks, individuals, corporations most likely beneficiaries of tax-credit

- *Funds mainly want coupon interest vs. tax-credit*
- *Foundations don't pay taxes and don't need the credit*

Financing Options

QUALIFIED SCHOOL CONSTRUCTION BONDS (cont.)

TAX CREDIT OPTION

DIRECT PAY OPTION



Investor base for tax credit bonds is extremely limited

- *Banks are typical investors looking for tax credits – they don't understand charter schools*
- *Very few tax credit bonds issued for charter schools since inception*
- *Likely requires a buyer that is involved in the local community and may be "mission" driven*

Financing Options

QUALIFIED SCHOOL CONSTRUCTION BONDS (cont.)

TAX CREDIT OPTION

DIRECT PAY OPTION



Instead of a tax-credit, the investor will receive coupon interest that is subject to income tax.

School will be reimbursed for the taxable interest it pays investors equal to the “tax credit” rate the day the bonds are sold

As a result, **the charter school pays a very low NET cost of capital**

Financing Options

QUALIFIED SCHOOL CONSTRUCTION BONDS (cont.)

TAX CREDIT OPTION

DIRECT PAY OPTION



RECENT EXAMPLE (IDEA Public Schools):

Taxable interest rate: 8.25%

Tax-credit rate (11/18/10): 5.49%

Net cost to school: 2.76%

Financing Options

QUALIFIED SCHOOL CONSTRUCTION BONDS (cont.)

TAX CREDIT OPTION

DIRECT PAY OPTION



Investor base for Direct-Pay QSCBs is thin

- *Banks, insurance companies, money managers are buyers*

Combining Financing Methods

Combining Financing Methods

TAX-EXEMPT BONDS and QSCBs

- ➔ **Very straightforward combination**
- ➔ **QSCBs used on shorter maturities**
 - *If net interest cost is lower than tax-exempt market*
 - *Remember, maximum maturity of 17-19 years*
- ➔ **Tax-exempt bonds used on longer maturities**
- ➔ **Can result in excellent amortization schedule**

Combining Financing Methods

TAX-EXEMPT BONDS and QSCBs – Case Study



IDEA Public Schools Rio Grande Valley, Texas

\$33,780,000
Education Revenue Bonds,
Series 2010A (**Tax-Exempt**)

\$120,000
Taxable Education Revenue
Bonds, Series 2010B

\$7,555,000
Taxable Education Revenue
Bonds, Series 2010Q (**QSCBs**)

- Began in 2000 with 1 school of 150 students
- 6,915 students on 8 campuses in 2010-11

Key Financing Features

- *Combination of QSCBs and Tax-Exempt Bonds*
- *Blended rate of 5.92% for 30-year financing*
- *Rated “BBB” by Standard & Poor’s*

Exit Strategy	% of Budget	Parity Debt	Ability to Prepay
<p>Permanent 30-year financing</p> <p>“Front-Loaded” Amortization</p>	<p>Projected 10% of Budget</p>	<p>Additional debt allowed if net revenues are greater than 1.20x MADS</p>	<p>Both Tax-Exempt bonds and QSCBs callable in 10 years at par</p>

Combining Financing Methods

QSCBs and NMTCs

- ➔ **NMTC Diagram (page 18)**
- ➔ **Can utilize QSCB as the leveraged loan source**
 - *Uses the original tax-credit approach to QSCB*
- ➔ **Brings in QSCB equity on top of NMTC equity**
- ➔ **Uses interest-only payment on leveraged loan as with traditional NMTC financings**
 - *Low impact on annual budget*
- ➔ **At end of compliance period, refinances only about 55% of the original project debt**

Combining Financing Methods

QSCBs and NMTCs – Case Study

American Preparatory Academies – Accelerated Charter School
West Valley City, Utah



\$7,900,000
Charter School Revenue
Bonds, Series 2010C
(QSCBs)

\$3,100,000
NMTC Capital Contribution

- Will open 2011
- K-12
- 720 students in 2011-12

Key Financing Features

- *Combination of NMTCs and Tax Credit QSCBs*
- *Low interest-only payment for compliance period*
- *Significant equity accrual*

Exit Strategy	% of Budget	Parity Debt	Ability to Prepay
<p>↓</p> <p>Will refinance only 55% of original debt with TEBs in 7 years</p>	<p>↓</p> <p>Interest only for 7 years</p> <p>Projected 8% of Budget</p>	<p>↓</p> <p>Additional debt allowed if conditions are met</p>	<p>↓</p> <p>Ability to refinance only after compliance period</p>

Combining Financing Methods

TAX-EXEMPT BONDS and NMTCs

- ➔ **Uses tax-exempt bonds as the leveraged loan source**
- ➔ **Uses interest-only payment structure during the 7-year compliance period**
- ➔ **Bond market requires payment guarantees (credit enhancement) during this compliance period**
 - *Due to forbearance requirement associated with NMTC*
- ➔ **Has the advantage of not requiring refinance at end of compliance period**
 - *No interest rate risk*
- ➔ **Payments similar to traditional NMTC structure during compliance period**

Combining Financing Methods

TAX-EXEMPT BONDS and NMTCs – Case Study

Academy of Learning and Leadership Milwaukee, Wisconsin



- Began in 2003
- K-8
- 264 students in 2006-07

\$7,800,000
Education Revenue Bonds,
Series 2007A (**Tax-Exempt**)

\$750,000
Taxable Education Revenue
Bonds, Series 2007A &
2007B

\$3,088,800
NMTC Capital Contribution

Key Financing Features

- *Combination of NMTCs and Tax-Exempt Bonds*
- *Blended rate of 5.28% before equity, 4.35% after equity*
- *Non-rated*

Exit Strategy	% of Budget	Parity Debt	Ability to Prepay
<p>Permanent 30-year financing</p> <p>Fully amortizing beginning in Year 7</p>	<p>Interest only for 7 years</p> <p>Projected 13% of Budget</p>	<p>Additional debt allowed if conditions are met</p>	<p>Callable in 10 years at par</p>

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