Financing Facilities for Charters in SC & How Other States Assist Charters with Facilities Costs

22nd Annual S.C. Charter Schools Conference

November 2nd

10:00 AM

ROOM TBD

HIGH POINT ACADEMY

BAIRD

HOWELL LINKOUS & NETTLES

TURNER CAUDELL

Introductions - *Today's Presenters*

Brian Kelso
Managing Director
Charter School Finance Group

Matt Nestberg
Board Chair

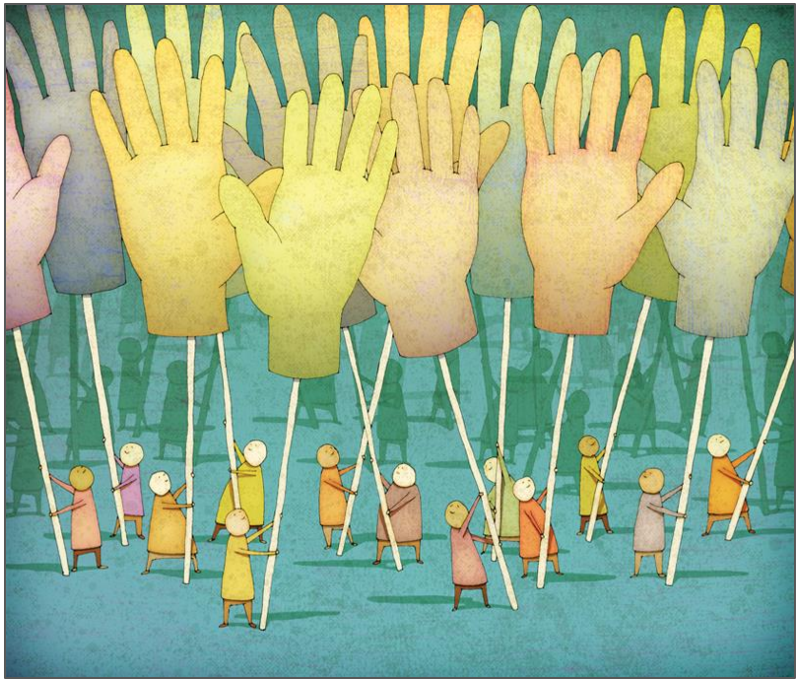
Tyler Turner
Partner

Alan Linkous
Partner

Introductions - *Audience Participants*

By a Show of Hands

- New schools?
- Schools currently leasing facilities?
- Schools looking to expand enrollment or grades?
- Schools looking to refinance existing debt and capital expenditures?



Presentation Outline

- **The Pre-Borrowing Plan**
- **Tax-Exempt Bonds**
- **Case Study – High Point Academy**
- **Other States Assisting Charter Schools with Facilities Costs**
- **Q&A**

The Pre-Borrowing Plan

Components of the Pre-Borrowing Plan

Pre-Borrowing Plan – Preparation

- Build the School First
- Assess Facility Needs (Current & Future)
- Establish a Strong Credit Profile
  - Demand factors
  - Financial factors
  - Governance and management

The above can be identified with help of a professionals: **Engaging professionals early** in the process can help with accurate assessments

- ✓ Investment Banking Team
- ✓ Municipal Advisor
- ✓ Real Estate Broker
- ✓ Architect
- ✓ Construction Management
- ✓ School/Network Counsel (Attorney)
- ✓ Foster banking relationships for interim financing and line of credit, if necessary

The Pre-Borrowing Plan - *Build the School First*

- **Mission:** What is it that you are doing that is of value? What problem are you solving?
- **Niche:** Defined but not narrow
- **Competition:** Awareness of other education options in the area. What's the value your school brings to the community?
- **Governance**
    - ✓ Administration
    - ✓ Board Composition
    - ✓ Back office support
    - ✓ Checks and balances
    - ✓ Conflicts of interest
- **Financial Health**
    - ✓ Liquidity / Access to cash
    - ✓ Balanced budget
    - ✓ Ability to afford now, or is growth required?

The Pre-Borrowing Plan - *Assess Facilities Needs (Current & Future)*

- **Current Facility**
  - ✓ Sufficient size for enrollment and/or demand?
  - ✓ Leased; Option to purchase later?
  - ✓ Renovations or expansion needed?
  - ✓ Land acquisition and new construction needed?

- **Growth Plans**
  - ✓ Are more campuses being considered for future growth?
  - ✓ Will more grades be offered?

- **Affordability**
  - ✓ Have basic financial projections been done to determine affordability?
  - ✓ Have assumptions been stress tested (enrollment, state funding, etc.)?

- **Current Issues**
  - ✓ Less certainty in enrollment trends
  - ✓ Increased land, materials, and labor costs

The Pre-Borrowing Plan - *Establish a Strong Credit Profile*

Demand Factors:

- ☑ **Enrollment:** Stable and/or increasing?
- ☑ **Waitlist:** Established and maintained?
- ☑ **Academic Results:** Strong test scores and/or improving trends (relative to the population being served)?
- ☑ **Student Retention:** At least 80% for each grade (preferably higher)
- ☑ **<u>Post COVID Impacts</u>:** Charters saw overall increased enrollment during the pandemic, but <u>lower demand is not uncommon (particularly for younger grades)</u> depending on circumstances

The Pre-Borrowing Plan - *Establish a Strong Credit Profile*

Details on how to calculate these select financial factors will be given later in our presentation

Financial Indicators:

☑ **Annual Debt Burden:** Below 15-20% of forecasted revenues?

☑ **Liquidity Position:** Days Cash on Hand of at least 45 days? Forecasted to increase?

☑ **Annual Debt Service Coverage:** Forecasted that net income will be at least 1.20x debt service? Based on historical operations or is enrollment growth needed?

☑ **<u>Post COVID Impacts</u>:** <u>Many charters have improved their balance sheet</u> positions as a result of stimulus funds (PPP & ESSER) and increasing state funding

The Pre-Borrowing Plan - *Establish a Strong Credit Profile*

Governance and Management:

- ☑ **Governance:** Board buy-in and business acumen? Established policies & procedures?
- ☑ **Charter Term:** At least one renewal? Helpful but may not be required.
- ☑ **Management:** Stable management delivering results?
- ☑ **Teacher Retention:** Low turnover?
- ☑ **Post COVID Impact:** Increased staff turnover and labor shortage issues. Some schools accessing financing prior to first charter renewal.

The Pre-Borrowing Plan - *Calculation of Select Financial Indicators*

- **Debt Burden: Below 15 to 20% of the School's "steady-state" budget**
  - ✓ **How to Calculate:**
    - **Annual Debt Service / Gross Revenues**
  - ✓ **What does it mean:** How much of a school's budget is used to pay facilities related debt. Higher percentage of revenues can be used for debt during times of enrollment growth
  - ✓ **Why does it matter:** Anything above these suggested maximums may negatively impact a school's academic and organizational success due to reduced dollars being spent in the classroom

The Pre-Borrowing Plan - *Calculation of Select Financial Indicators*

- **Annual Debt Service Coverage: At least 1.10x to 1.20x; higher levels ideal at "steady state" budget**
  - ✓ **How to Calculate:**
    - **Net Income Available for Debt Service / Annual Debt Service**
      - Net Income = Unrestricted Revenues - Operating Expenses
        - Note: Operating Expenses exclude noncash expenditures such as depreciation
  - ✓ **What does it mean:** How much money is left to pay debt service after covering operating expenses. Excess funds after debt service can be used to build reserves and/or capital expenditures.
  - ✓ **Why does it matter:** Anything above these suggested maximums may negatively impact a school's academic and organizational success due to reduced dollars being spent in the classroom

The Pre-Borrowing Plan - *Calculation of Select Financial Indicators*

- **Days Cash on Hand: At least 45 days; new schools may be able to "grow" into this liquidity level**
  - ✓ **How to Calculate:**
    - **Unrestricted Cash / (Annual Operating Expenses / 365)**
      - Note: Operating Expenses exclude noncash expenditures such as depreciation
  - ✓ **What does it mean:** A measure of a School's liquidity. Assuming annual operating expenses are equal throughout the year (they aren't), how many days can an organization pay operations from its balance sheet (assuming no incoming revenues).
  - ✓ **Why does it matter:** Low days cash on hand provides limited financial flexibility to respond to unforeseen expenses, inflation, and maintenance costs.

The Pre-Borrowing Plan - *Primary Financing Methods Available*

A Charter School Bond provides a long term permanent financing and is the only option that removes interest-rate (refinance) risk.

"Real Estate" Lenders (Traditional Bank Loans; New Markets Tax Credit; Developer Financed Lease Purchase)

"Cash Flow" Lenders (CDFI's; Charter School Bonds)

Types of Financing	Traditional Bank Loans	New Markets Tax Credit ("NMTC")	Developer Financed Lease Purchase	CDFI's	Charter School Bonds
Generally Appropriate For:	Newer or seasoned Schools, interim construction possible	New or more seasoned, but project must be in a "qualifying area" defined by census track and poverty levels OR serve targeted population	Newer Schools or with limited staff; Interim Financing until Permanent Takeout Available	Seasoned schools or new schools of experienced operators	Generally, more seasoned school or organizations; growing acceptance of new/startup schools
Amount Financeable (Loan-to-Value):	70–80%	+/-90-100%	Flexible but reflected in cost of lease	65-80%	+/- 100%
Typical Term:	5-10 year term with 20-25 year amortization	Usually interest only for the first 7 years	20–30 years	5-7 years	30-35 years, fully amortized fixed rate
Appraisal Requirement:	Yes	Generally, yes	Depends	Yes	Generally, no
Required to Refinance?	Yes	Yes	Typically Yes, but restrictions can apply	Usually	No; option of school if advantages
Complexity	Low	High	Medium	Low	Medium
Typical Time Required to Close	+/- 30 days	+/- 90-120 days (or longer)	+/- 60 days	+/- 60-90 days	+/- 90 days
Other:	Lender may require all deposits and credit lines	20-25% on loan normally "forgiven" at end of year 7	May require minimum rate of return. One-stop shopping		Various covenants required to maintained

Sample Financial Projections – High Point Academy (2018 Bonds)

	Revised Budget			Projected		
Enrollment	**1,257**	**1,304**	**1,348**	**1,392**	**1,422**	**1,438**
	2018-2019	2019-2020	2020-2021	2021-2022	2022-2023	2023-2024
Revenues:						
Local Funding	$ 615,900	$ 646,695	$ 679,030	$ 712,981	$ 748,630	$ 786,062
Charter School Funding	6,057,410	6,089,645	6,311,110	6,526,814	6,686,582	6,768,346
Fringe Benefits Employer Contribution	1,285,567	1,381,656	1,474,860	1,571,027	1,657,768	1,728,380
Other State Funding	541,850	778,029	816,930	857,777	900,666	945,699
Education Finance Act	4,043,841	4,288,125	4,531,727	4,777,266	4,987,076	5,142,063
2% District Fee	(236,457)	(244,189)	(255,354)	(266,502)	(275,629)	(281,776)
Federal Funding	453,949	489,853	514,346	540,063	567,066	595,419
Total Revenue	$ 12,762,060	$ 13,429,814	$ 14,072,649	$ 14,719,426	$ 15,272,160	$ 15,684,193
Total expenditures	**$ 10,592,720**	**$ 11,077,399**	**$ 11,643,978**	**$ 12,212,558**	**$ 12,726,031**	**$ 13,151,117**
Net available for Debt Service	**$ 2,169,340**	**$ 2,352,415**	**$ 2,428,671**	**$ 2,506,868**	**$ 2,546,130**	**$ 2,533,076**
Existing Facility Lease Payment (1)	742,142	-				
Series 2018 A&B Principal Expense	-	140,000	245,000	345,000	415,000	470,000
Series 2018 A&B Interest Expense	739,441	1,521,135	1,512,735	1,498,835	1,480,895	1,459,315
Total Debt Service	**$ 1,481,583**	**$ 1,661,135**	**$ 1,757,735**	**$ 1,843,835**	**$ 1,895,895**	**$ 1,929,315**
Coverage Ratio (Annual Debt Service)	**1.46**	**1.42**	**1.38**	**1.36**	**1.34**	**1.31**
Beginning Cash (2)	2,707,029	3,394,786	4,086,066	4,757,002	5,420,034	6,070,269
Net Operating Surplus (Deficit)	687,757	$ 691,280	670,936	663,033	650,235	603,761
Ending Cash	3,394,786	4,086,066	4,757,002	5,420,034	6,070,269	6,674,030
Operating Expense per Day	**$ 33,080**	**$ 34,517**	**$ 36,046**	**$ 37,565**	**$ 38,923**	**$ 40,029**
Days Cash on Hand	**103**	**118**	**132**	**144**	**156**	**167**

(1) Rent expense though December 31, 2018

(2) Ending Cash and Investments - Fiscal 2018 Audit

Tax-Exempt Bonds

Tax-Exempt Bonds - *Uses*

- **What Can be Financed with Bonds? – 100% of Project, Reserves and Costs of Issuance Can be Financed**
  - ✓ New building construction
  - ✓ Building acquisition
  - ✓ Land
  - ✓ Computers/technology equipment
  - ✓ Buses/transportation
  - ✓ Renovate existing facilities
  - ✓ Payoff capital leases
  - ✓ Refinance existing debt – bank loan or a prior bond issue
  - ✓ Sports facilities (example: gymnasium)
  - ✓ Financing costs and Reserves
- **Above Listed Projects Can be Financed "Tax Exempt"**
  - ✓ Provides a lower borrowing cost
  - ✓ Discuss any potential uses of the facilities early in the financing process. Other entities using the facilities may trigger "private use" and impact tax exempt status

Tax-Exempt Bonds - *Structure*

- **100% Financing: No loan-to-value requirements**
  - ✓ Permanent Financing – No refinance risk
  - ✓ Amortization of 30-35 years, or more
  - ✓ Alternative structures available, such as a 5-10 year "term" with a balloon payment that will be required to be refinanced
- **Option to refinance if economically advantageous**
  - ✓ 10 year optional call is standard; shorter calls, up to 5 years, becoming increasingly common
  - ✓ School's option to refinance, e.g. for savings if rates are lower
- **Investor base the most developed of any funding source**
- **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 (or other outside sources)
  - ✓ Used to pay investors if payment not made by school
  - ✓ Used to make final year's payment

Tax-Exempt Bonds – *Typical Security & Primary Financing Covenants*

SECURITY

- **Gross Revenue Pledge:** First lien on all revenues of the school
- **First Mortgage on Capital Assets:** Fee simple title to school facility being financed.
- **Debt Service Reserve Fund ("DSRF"):** Bond proceeds would be used to fully fund a DSRF. The DSRF requirement is usually based on the lesser of (i) 10% of original par amount of the bond issue, (ii) maximum annual debt service, or (iii) 125% of average annual debt service.

PRIMARY FINANCING COVENANTS

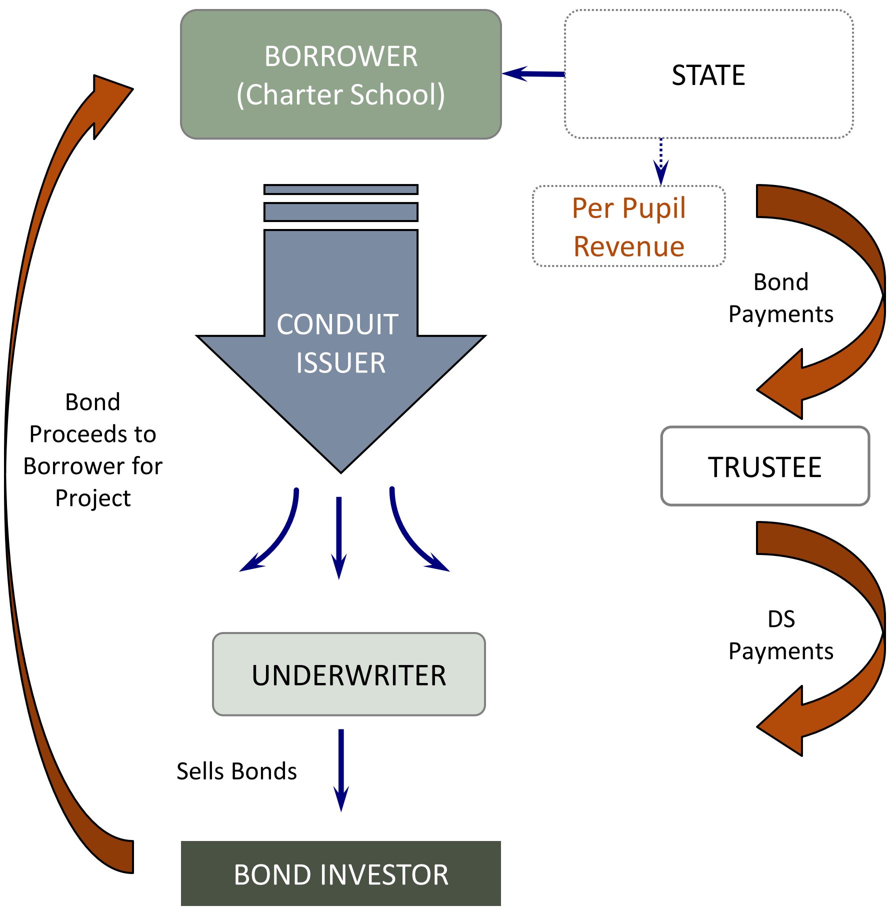
- **Debt Service Coverage Covenant:** Maintain debt service coverage of at least 1.10x.
- **Liquidity (Days Cash on Hand) Covenant:** Maintain cumulative unrestricted cash reserves sufficient to meet 45 days operating expenses.
- **Repair & Replacement ("R&R") Fund:** Maintain R&R fund in an amount equal to $100,000, to be funded in equal monthly deposits over five years.
- **Additional Indebtedness:** (i) net revenues of most recent audit are sufficient to pay at least 110% of existing and proposed combined maximum annual debt service or (ii) projected net revenues will equal not less than 120% of existing and proposed combined maximum annual debt service.

Tax-Exempt Charter School Bond Structure

Primary Transaction Participants

Structure can be tailored to needs of the charter school

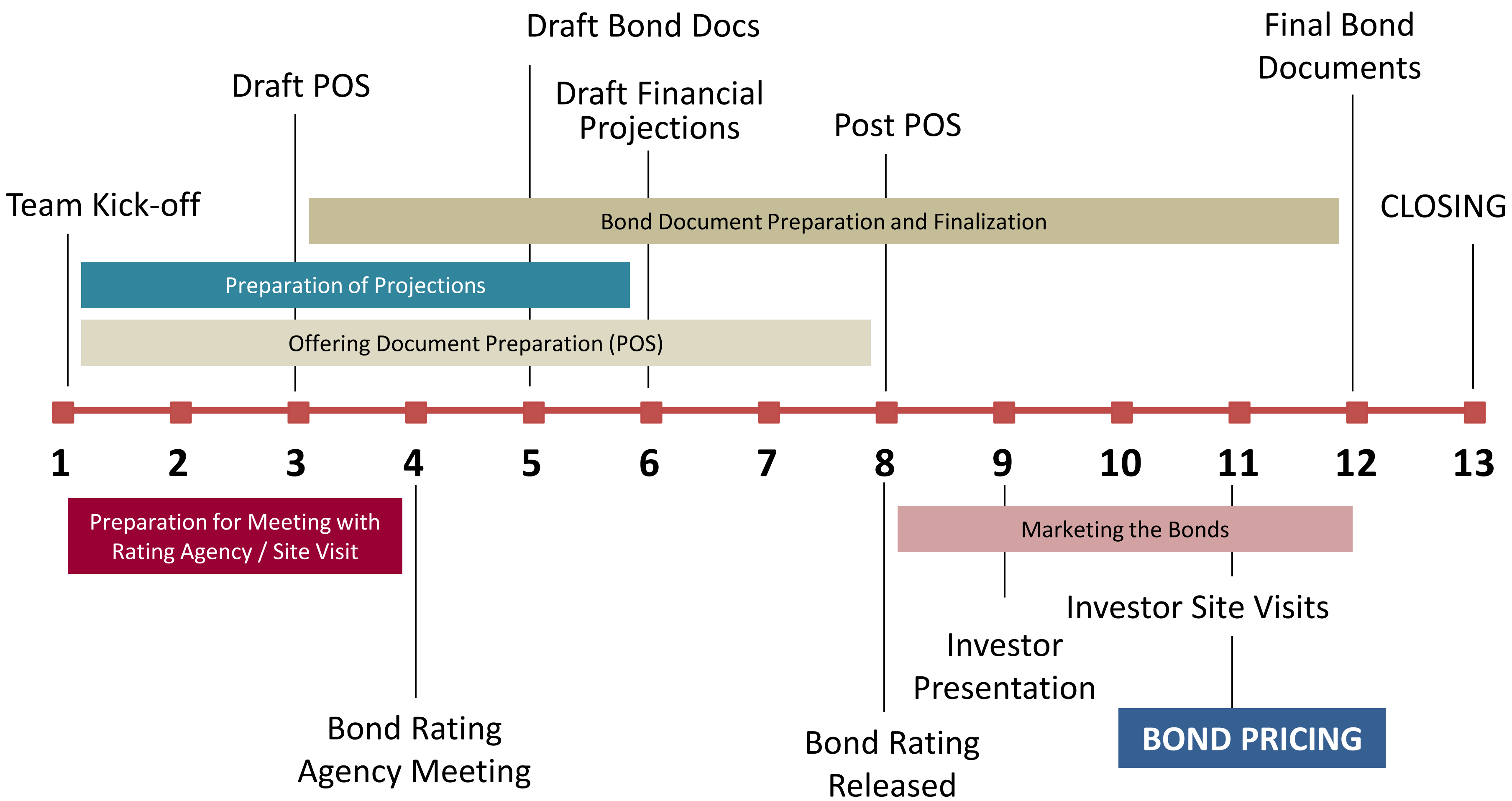
TYPICAL CHARTER SCHOOL BOND STRUCTURE



PRIMARY TRANSACTION PARTICIPANTS

- Borrower / Obligor –Charter School
- Borrower's Counsel – corporate counsel of the borrower, reviews all legal documentation for accuracy and authority, reviews or prepares real estate documents
- Bond Counsel – drafts primary bond documents (trust indenture, lease agreement, and loan agreement) and renders tax opinion
- Issuer – conduit issuer through which the bonds are offered such that all tax and legal objectives (opinions) are achieved. **South Carolina Jobs-Economic Development Authority** is common issuer in the state
- Issuer's Counsel – reviews all documents on behalf of the issuer primarily to ensure that no financial obligation rests with the issuer
- Underwriter – structures the bond financing, evaluates credit, negotiates covenants, and markets the bonds to investors
- Underwriter's Counsel – reviews all documents on behalf of the underwriter and constructs the bond purchase agreement and the offering document
- Financial/Municipal Advisor – acts as an independent advisor to the Borrower with a fiduciary responsibility to the school
- Rating Agency – third party evaluation of the transaction; not part of team in terms of structuring and credit decisions
- Trustee – fiduciary responsibility to hold bond funds (DSRF), makes draws for principal and interest and represents the bondholders
- Investors – purchases the Bonds

Tax-Exempt Bonds – *Timing by Week (General)*



Common Mistakes - *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
  - Conditional use permit (if applicable)
  - Zoning ordinances and building restrictions *(becoming a tool for Cities and School Districts to restrict Charters)*
  - Property tax information
  - Access, utilities, and other municipal services
  - **GET ALL NECESSARY APPROVALS**

- **For bonds (and most other financing vehicles), <u>the real estate being financed is pledged as collateral</u>**
  - ✓ Financing cannot be completed without finalizing all the above
  - ✓ Real estate related items are the most common issues that delay a financing

Case Study – High Point Academy

High Point Academy
Spartanburg, South Carolina

$26,895,000	Educational Facilities Revenue Bonds
$26,645,000	Series 2018A (Tax-Exempt)
$250,000	Series 2018B (Taxable)

December 2018
Baird served as Senior Managing Underwriter

High Point Academy

Mission: High Point Academy is a community-centered school built on the principles of honor, integrity, and service where academic excellence, STEAM education, and a project-based, applied learning instruction builds tomorrow's leaders.

Vision Statement: The Academy is built on the principles of honor, integrity, and service. Its teachers challenge students in an applied learning style of instruction with an emphasis in S.T.E.A.M (science, technology, engineering, arts, and math) education as well as character and leadership development. Through a partnership with family and community, each student will strive to achieve their highest potential academically, socially, and personally.

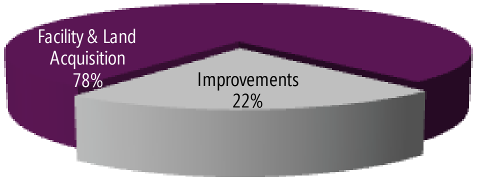
Financing Need:

- Finance the acquisition of the currently leased land and existing facilities
- Acquisition of an adjacent parcel of land
- Construction of a gymnasium
- Renovation and equipping of certain improvements to the facility.

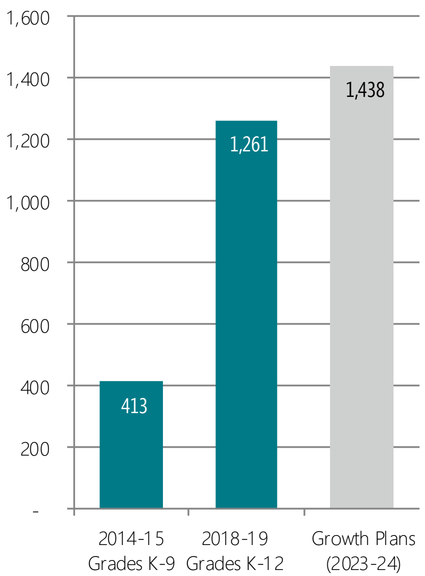
Financing Results:

- Moody's Bond Rating of "Ba1" (stable outlook)
- 31-year fixed rate financing
- Secured a True Interest Cost ("TIC") of 5.42%

Financing Purpose



Enrollment



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Other States Assisting Charter Schools with Facilities Costs

Facility Funding Summary

Examples of Financial Support for Facilities Costs				
	Name of Funding	**Short Description**	**Eligibility Requirements**	**Notes**
California	Charter School Facilities Grant Program ("SB740")	Per Pupil Revenue from the state. Must be used towards a lease payment for facilities. Legislatively created.	55%+ of students at the school must be eligible for FRL	Subject to annual budget process. Pro-rata allocation if more applicants then funds. Bonds/debt can be structured with a lease to be eligible.
Colorado	Charter School Capital Construction Program	Per Pupil Revenue from the state. Can be broadly used for capital costs (leases, one-time expenditures, maintenance, etc).		Subject to annual budget process. Total fund distributed on a per pupil basis.
New York City	Facilities Access Program	Charter applies to NYC DOE for facility space (co-locate, unused building, etc). If none provided or space is not "reasonable, appropriate, compatible and in reasonable proximity" the charter school can appeal for the "rental assistance".	Charter school must have commenced instrctuon or added grade levels in the 2014-15 school year or thereafter.	
Florida	Charter School Capital Outlay	Per Pupil Revenue from the state. Can be broadly used for capital costs (leases, one-time expenditures, maintenance, etc).	1. Existed for 2 years, 2. good fiscal health, 3.satisfactory student achievement, & 4. not be in a district/authorizer building.	Additional supplements for 75%+ FRL or 25% students with disabilities.
Texas	State Facilities Funding	Per pupil revenue from the state. Can be broadly used for lease expenses, property taxes, bond/debt service payments, and maintenance.	"Acceptable" academic performance rating.	

Bond Ratings Scale & Charter Schools

Range of "enhanced" charter school bond programs

Typical range of rated charter school bonds

Moody's Long-Term	S&P Long-Term
Aaa	AAA
Aa1	AA+
Aa2	AA
Aa3	AA-
A1	A+
A2	A
A3	A-
Baa1	BBB+
Baa2	BBB
Baa3	BBB-
Ba1	BB+
Ba2	BB
Ba3	BB-
B1	B+
B2	B
B3	B-
Caa1	CCC+
Caa2	CCC
Caa3	CCC-
Ca	CC
	C
C	D

Investment Grade

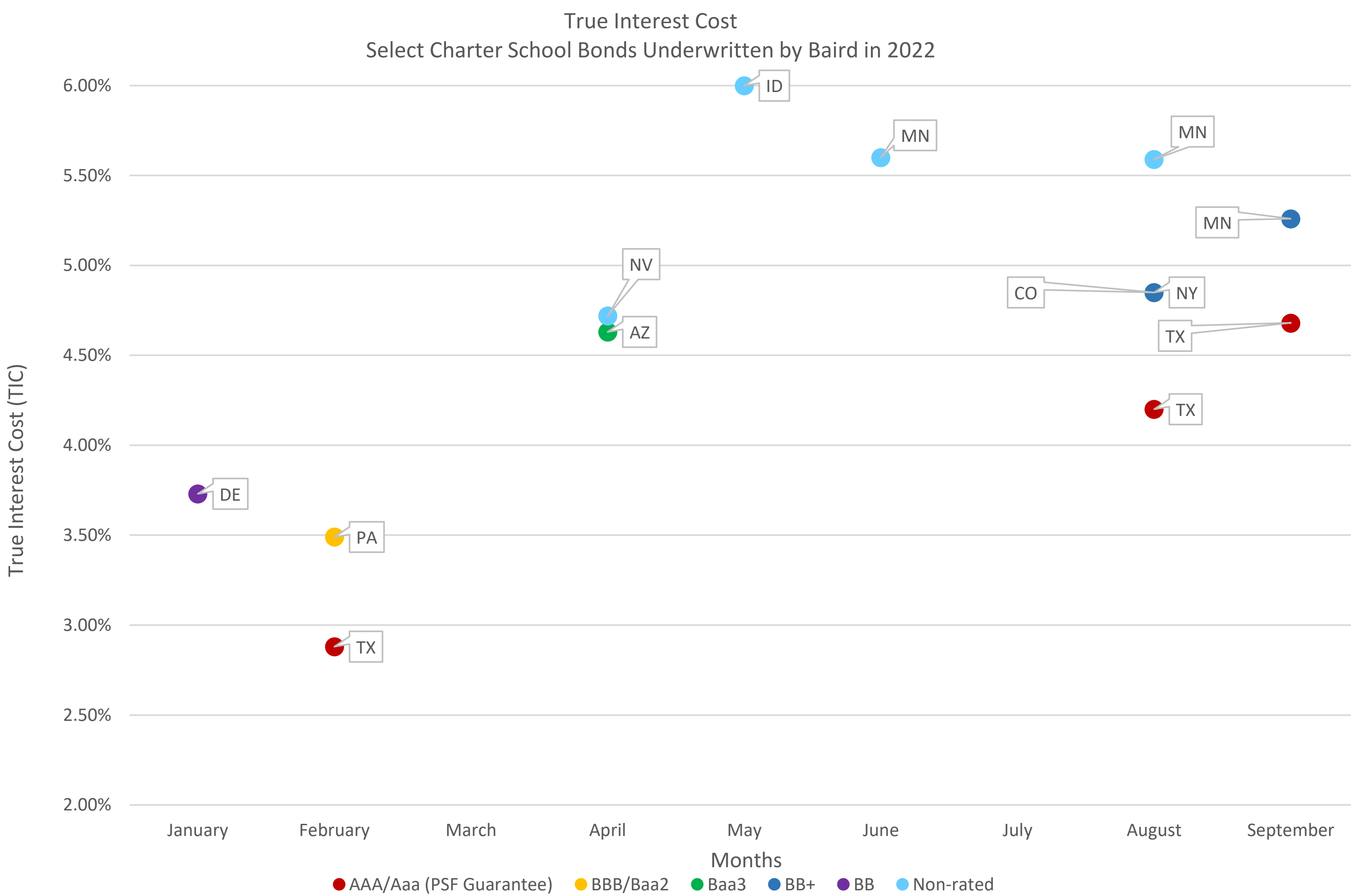
Non-investment Grade

State Enhancement Programs

State Credit Enhancement Programs for Charter School Bonds

State	Type of Guarantee	Rating	Year Created	How Charters Qualify	Notes
Arizona	Full Faith Pledge	AA-	2017	Academic performance; no 3rd party credit review	At capacity
Colorado	Moral Obligation	Aa3/A+	2002	Investment Grade Rating	
Idaho	Moral Obligation	Aa2/A+	2019	Good academic, financial, and operational standings. No 3rd party credit rating.	At capacity
Texas	Permanent School Fund	AAA/Aaa	2011	Investment Grade Rating	
Utah	Moral Obligation	AA/Aa2	2012	Investment Grade Rating. Exceptions for small, established schools with good academic performance	

TIC - Select Charter School Bonds Underwritten in 2022



Charter Management Organization Structure Example -- Colorado

- **Colorado passed legislation in 2015 to allow for the creation of Charter School Networks (or Charter Management Organizations/CMO)**
  - ✓ Prior to this time, "networks" existed in an informal sense with each school a separate legal entity
  - ✓ Allows a CMO to operate multiple schools in multiple locations with one or more authorizer
  - ✓ A network can conduct a single financial audit
  - ✓ Financial and other resources can be "pooled". For example**, the financial strength of existing campus(s) can be leveraged** by pledging financial support to new or startup campuses
- **Greatly simplifies the replication process for a successful charter school to open new campuses**
- **Inherent economies of scale from a larger organization**

Q&A