Facilities Financing: Landscape & Strategy REMIX - 2023

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What changes have you seen in the market in the past two years?

How has your school overcome these challenges?

Would we rank lending differently from two years ago?

Now Rank Your Lender (1 Minute)

Turner Impact Capital

Self-Help Credit Union

HJ Sims

Pinnacle Financial Partners

IFF

Capital Impact Partners

Schoolhouse Development LLC

Charter School Capital

D.A. Davidson — The Strength of Advice

USDA

LISC

American Charter Development & Finance

Charter School Growth Fund

Wells Fargo

Charter Schools Development Corporation

Truist

Civic Builders

Equitable Facilities Fund

Reinvestment Fund

How did you rank your lender and why?

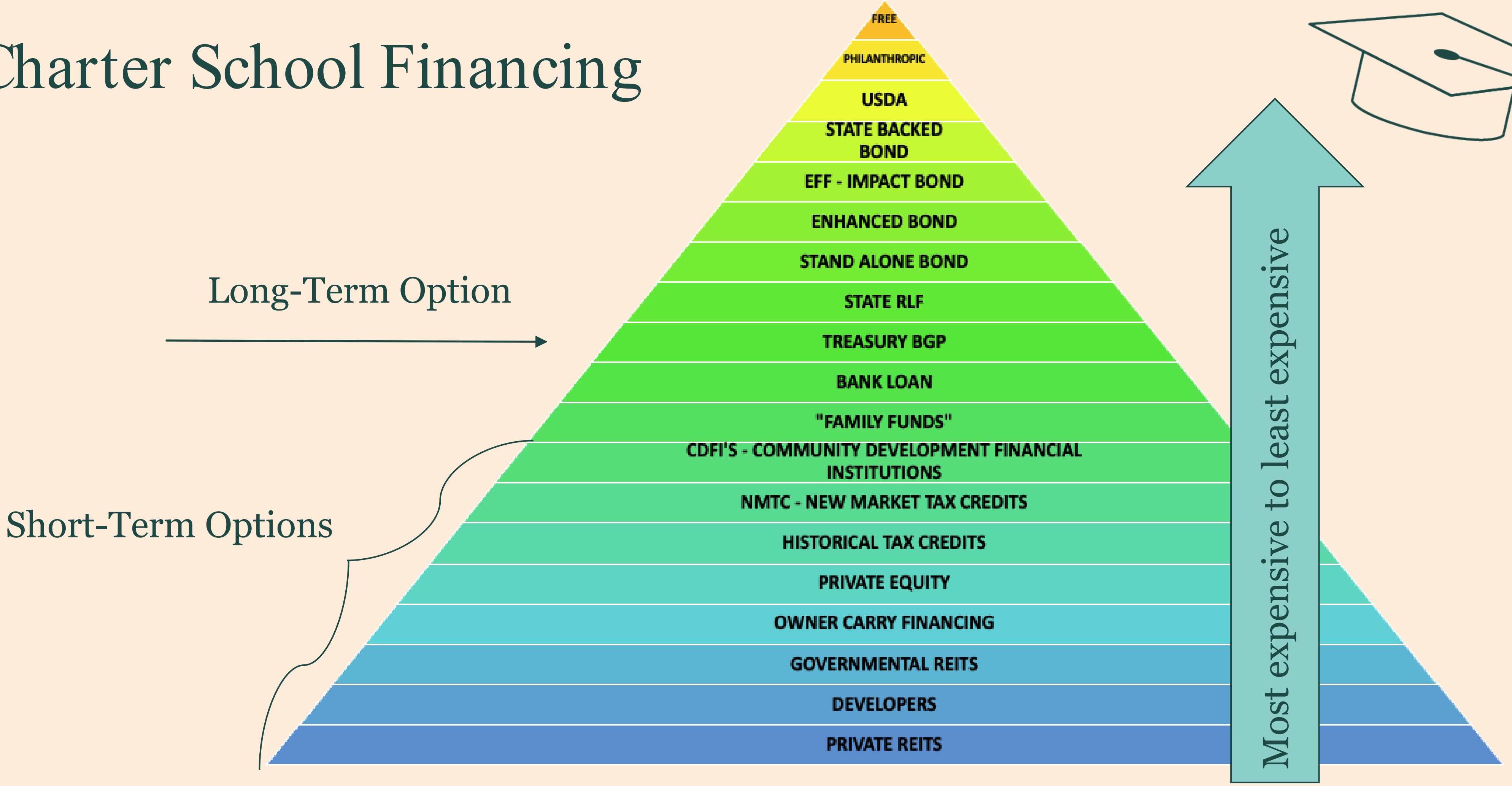
Goals of the Presentation

Participants will:

- Understand the various capital markets charter schools have access to
- Understand the various pathways to lending
- Leave with questions to ask their lenders
- Leave with questions to consider for developing a facility strategy (for financing)

What are some of the financing options for state charter schools? How do they compare?

Types of Charter School Financing



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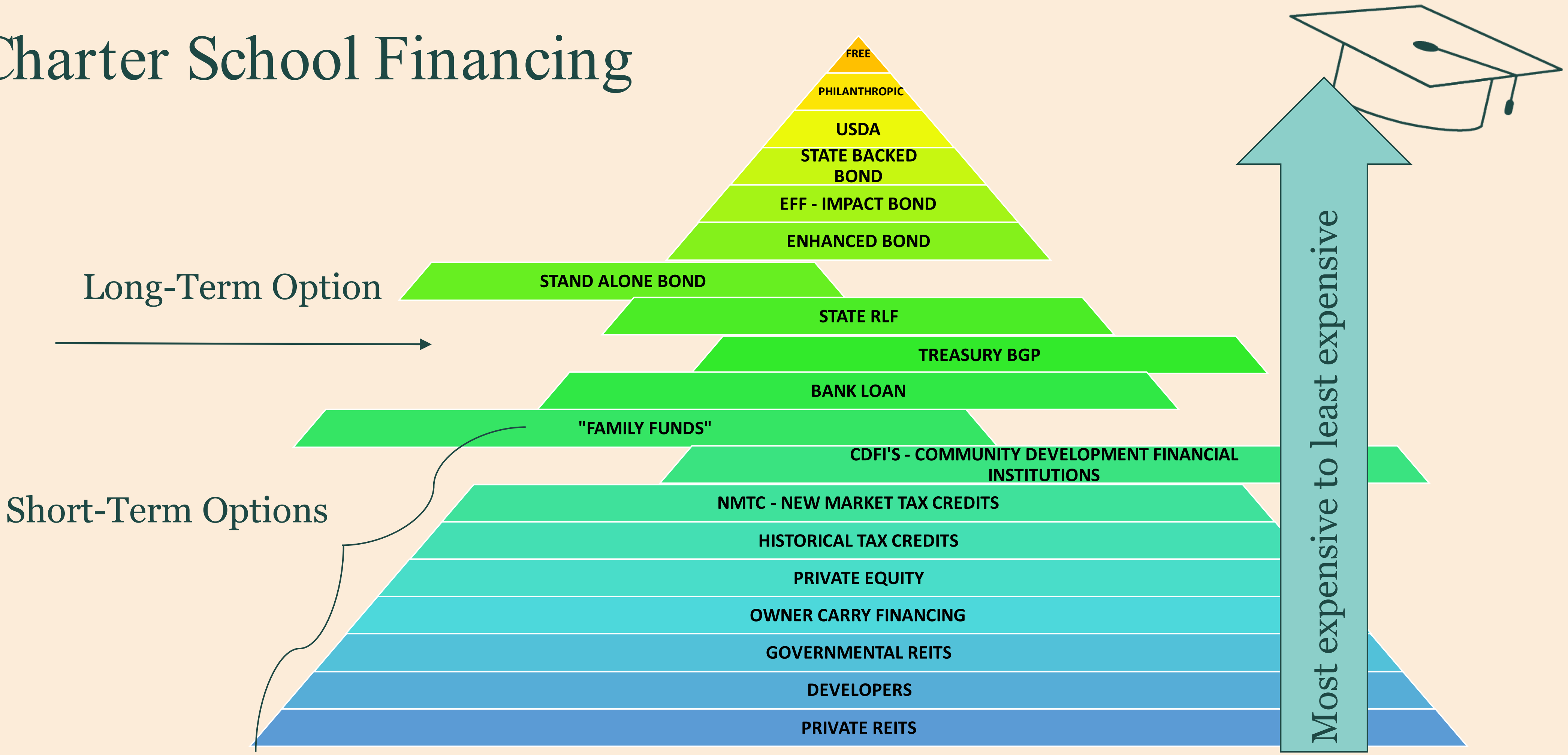
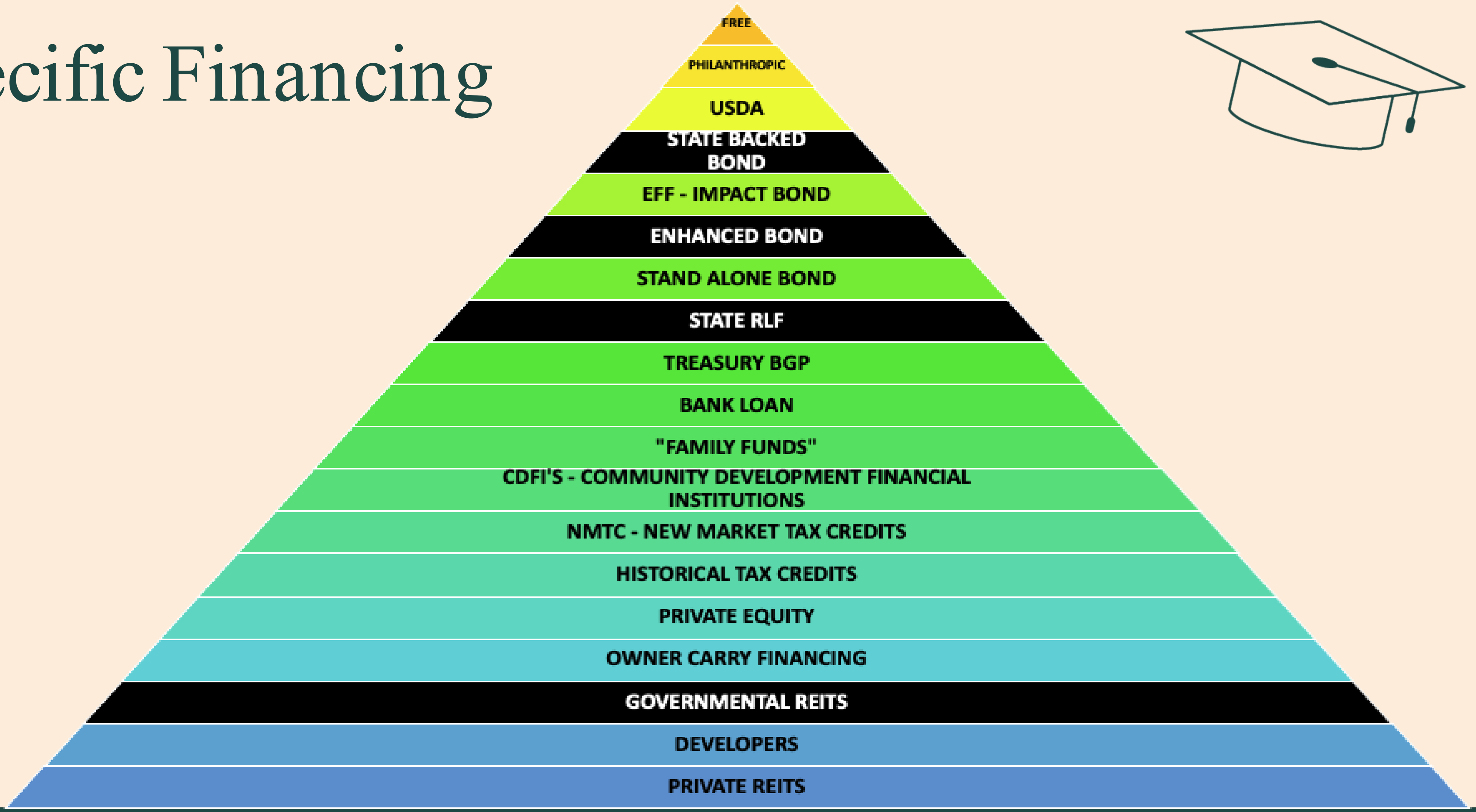


Georgia Specific Financing



Common Types Of Charter Loans

	Developer	NMTC	Bank Loan	USDA	Long Term Debt
Term	3-7 years	7 years	5-7 years	40 years	30-40 years
Estimated Rate Range	~~8%-12%~~ **8%-17%**	~~4%-8%~~ **5.8%-9.5%**	~~3%-6.5%~~ **5.8%-9.5%**	~~2%-3%~~ **4.5%-5.5%**	~~3.95%-6%~~ **6.25%-9%**
Rate Change	yes	upon refi	yes/refi	no	no
Prepayment	no	no	yes	yes	yes
Fees	20%-25%	2%-3%	1%-2%	1%-2%	4%-5%

Developer Financing

- **Significant up-front expenses**
  - Developer fee of 2-10%
  - GC fee up to 10%
  - Annual escalators of 3-12%
    - Subject to “right-sizing” and “growth strategy”
- **Typical covenants:**
  - DSCR of 1.05 to 1.20x and minimum days cash on hand 30-75
- **Ownership:**
  - Acquisition can be preset with a “bullet” or defined maturity date
    - Acquisition at any time
    - Acquisition within a window (3-5 years) if not sold off to reit
    - Acquisition with decreasing purchase price (year 5 @120%, year 7 @115%, etc.)
    - Acquisition with an increasing purchase price (Year 2 @ 115%, year 3 @ 117%, etc.)
- **Risks:**
  - Project control is owned by developer
  - High up-front and hidden fees
  - Quality of building
  - **Acquisition challenges**

CDFI Financing

Community Development Financial Institution - Traditionally a non-profit lender with a mission and focus aligned with that of their clients (i.e. charters)

- **Traditionally leverage federal credit enhancements to offset risk.**
- **Will loan to year 0 charters**
- **Terms are structured to support borrower:**
    - LTV 100% or 120%
    - DSCR of 1.05x to 1.20x
    - Subordinate lender or Senior Lender
    - Unsecured Loans for Tenant Improvements
    - Longer interest only periods
    - Longer amortization periods
- **Risks:**
    - **At times** higher interest rates than other lenders
    - First right of refusal in covenants
    - **At times** prepayment penalties
    - Academic underwriting - much more focused on credit risk as a school

NMTC Financing

New Market Tax Credits - Treasury Department sets an annual limit on tax credits for use.

- Only ~320 charter schools in history have ever received since inception of the charter law
- Traditionally structured to allow for about a 15% equity to be reverted to the school at the end of the term
- Has a "bullet" single maturity of 7 years (market rate risk)
- Covenants are structured to protect the credit investor
- Will require a lender to cover about 80% of the total project
- Risks:
    - Timelines for construction
    - No equity at the end
    - High transaction costs - legal fees, consultants etc.
    - 7 year refinancing rate risk

Bank Loan Financing

- Local bank may be very different than a national bank - relationships matter
- Typical term is 5-7 years with a 20-25 year amortization period
- School will typically need to refinance every 5-7 years
- Typically require minimal reporting
- Traditionally only covers ~ ~~75%-80%~~ **45%-70%** of the loan
- Risks:
  - Rate changes when it comes to refinance
  - Prepayment penalties
  - Require significant equity contribution from the borrower or a guarantee
  - **Harder underwriting**

USDA Financing

U.S. Department of Agriculture - schools residing in rural communities serving students can access direct lending program.

- Must be in an area that qualifies for USDA (less than 20,000 residents)
- Average rate 3.64% (averaged from 2011 to 2019)
- Current rate is about ~~2%~~ **4.75%**
- Amortized over 40 years
- Risks:
    - Process is long and takes a long time to complete
    - If there is a government shutdown, the process is paused
    - Significant expertise required to successfully receive
    - Must be operational for 5 years

Financing through Long Term Debt

Default rate in GA long term debt is over 36% and the national average is under 5%

- Some schools in GA have issued bonds with an average term of 30-40 years
- Not all long term debt is equal - ask underwriter/lender how they are pricing and for recent comps
- Some allow for a build up period – capitalized interest
- A lenders fiduciary is that of the investor - not the school
- Risks:
  - High transaction costs
  - Limited flexibility with optimal redemption (call) features
  - Covenants geared towards protecting the investor
  - Can prohibit additional/future growth

That’s quite a few options!

Do you have a favorite and if so, why?

Does the “age” of the school matter?

Is there a “right” time to pursue financing?

Credit Risks As Classified by Charter Maturity

Year 0-3

- Limited days cash on hand
- Newly operating entity
- Academic performance - not measured/nominal measurement
- Financial performance - not measured/nominal measurement
- Enrollment and Product Demand - unproven

Year 4-5

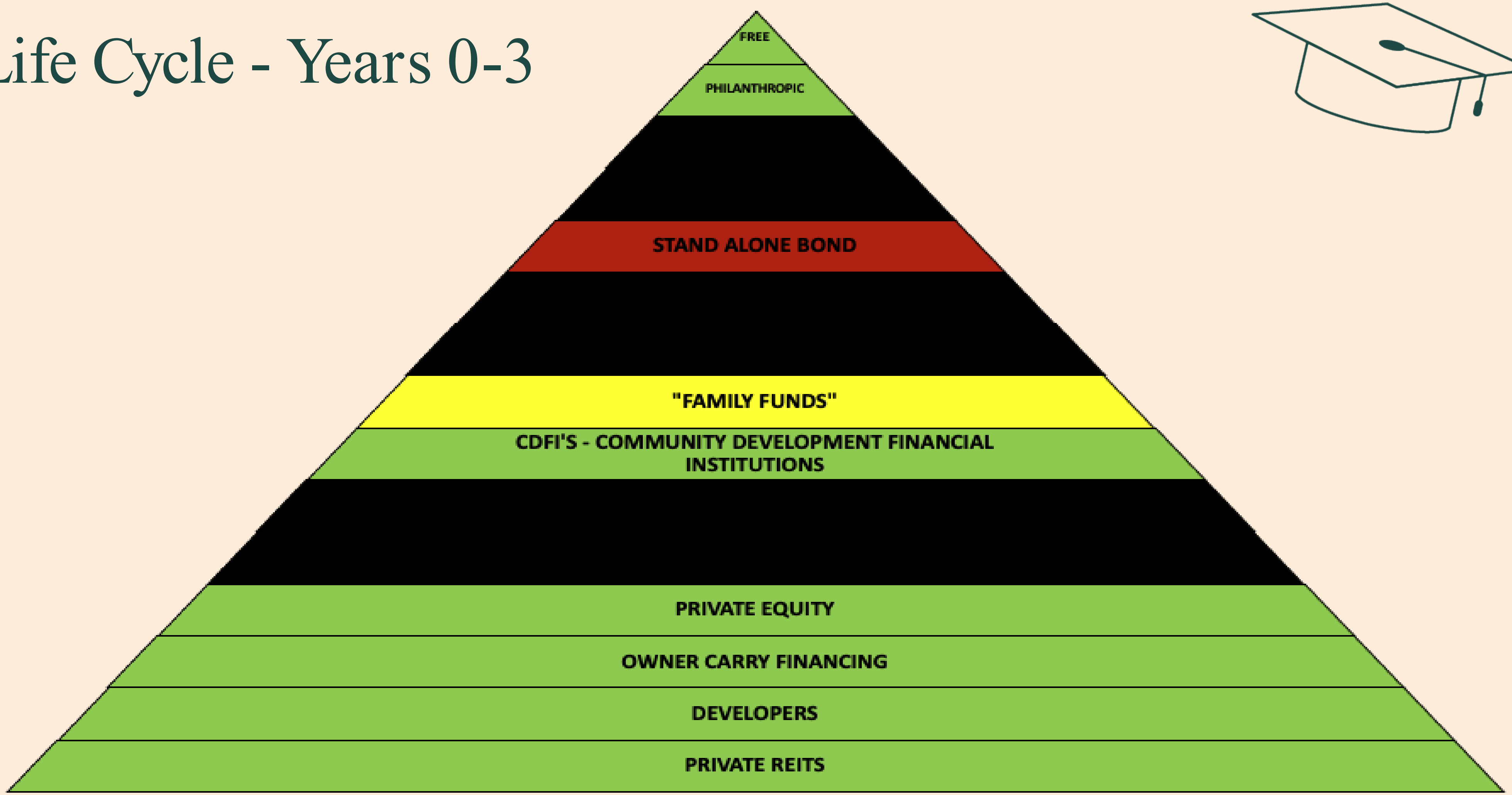
- 3 years of audited financial statements
- Built up days cash on hand
- Some academic performance measurement
- Growing enrollment - application/anticipated enrollment: actual enrollment
- Waitlisted students by grade level

Credit Risks As Classified by Charter Maturity (continued)

Years 5+

- Balanced budget/stable days cash on hand
- Maybe fully enrolled or still growing
- Waitlists
- Academic consistency

Lending Life Cycle - Years 0-3



Lending Life Cycle 4 to 5 Years

Lending Life Cycle Years 5+

How should we go about selecting a lender?

Questions to Ask Lenders

3 Phases of Financing: **Beginning**, **During**, and **After**

- What is the origination fee or total anticipated cost of issuance?
    - I.e., how much will it cost me to borrow money?

- What are the covenants and conditions attached to the debt/issuance?
    - Prepayment penalties, first right of refusal, "bullet" single maturity date, additional debt?

- What are the costs/fees and reporting requirements during the term of the loan/issuance?
    - Annual investor calls, enrollment reporting, academic reporting, monthly financials, etc.

- How much does it cost to exit this market?
    - Prepayment penalties, annual escalators, first right of refusal

Financing Strategy

- How will the debt I use today impact my tomorrow?
- What does my debt look like in 5, 10, 15, 20, 30, 40 years?
- What is the long-term solution for my facility?
- If I needed to add grade levels or replicate my school does my debt allow that?
- Should I refinance my debt or stabilize my debt burden to be long term?
  - When can I refinance?
- What are my maturity dates, call dates?
- As I grow will I need to take on an additional lease to accommodate growth or finance a new project?

What if my school already has facility financing and things aren’t going well?

What are our options?

I need to refinance!

What do I do?

I need to refinance - What do I do?

We need to look at a few things first:

- How did we get here?
- Can we refinance?
- How much does it cost?
- Could there have been a better way?

How did I get here?

Common paths:

- Developer Deal
- Maturing Loan
- Balloon Payment
- Bad Bond Deal
- New Development

I started building out my project 1 year ago, how do I fix the budget?

New Site Strategy

Common fixes:

- Temporary Spaces
- Lease to Purchase
- Minimize Footprint
- Underutilized Facilities (churches, offices, etc.)

Project Costs

Common fixes:

- Square Footage Reduction
- Phased Approach
- Finishes
- Some Value Engineering (VE)
- New vs. Pre-existing

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STATE CHARTER SCHOOLS COMMISSION

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Let’s dive into a common GA approach – Developer Deal

Developer Deal

Your school used "No Hassle Charter School Developer" (NHCSD) to handle your facility problem.

- They provided a "turn-key solution" for a nominal fee. (5%)
- They even said they'd only mark up the payment to be a little higher than what they pay on the loans.
- And...you can buy the building from them when the time is right.
- ...for a nominal fee

Let’s do the math!

Project Cost

Phase I	
Acquisition	$2,000,000.00
Closing Costs	$80,000.00
Site Work	$85,000.00
Improvements - hard costs	$2,500,000.00
Soft Costs	$375,000.00
Capitalized Interest	$151,200.00
Developer Fee	$259,560.00
Contingency	$545,076.00
Total Project Cost	$5,995,836.00

Developer Financing			
	Sr. Debt	*Sub Debt*	*Total*
	NHCSD Lender Buddy Bank	Private Equity/CDFI	
Loan Amount	$4,796,668.80	$1,199,167.20	$5,995,836.00
LTC	80%	20%	100%
Interest Rate	6%	7.50%	
Am term	20	25	
Monthly Payment	$34,364.83	$8,861.74	**$43,226.57**
Annual Payment	$412,377.96	$106,340.88	**$518,718.84**

Monthly Lease Payment to Developer (1.25)	**$54,033.21**
Annual Lease Payment to Developer (1.25)	**$648,398.55**

It’s handled, and now for the purchase!

- **Purchase options vary:**
  - Some have limited windows (3-5 years)
  - Some have escalating purchase options
    - *Y2 @ 115%, Y3 @ 116%, Y4 @ 117% etc.*
  - Some have deescalating purchase options
    - *Y5 @ 120%, Y7 @ 115%, Y10 @ 112%*
  - Some have flat rates
    - *Purchase at any time at 105%*

So how do we finance this?

Project Cost = $5,995,836

Premium Purchase Price: @107% = $6,415,545

Original Project Costs:

Phase I	
Acquisition	$2,000,000.00
Closing Costs	$80,000.00
Site Work	$85,000.00
Improvements - hard costs	$2,500,000.00
Soft Costs	$375,000.00
Capitalized Interest	$151,200.00
Developer Fee	$259,560.00
Contingency	$545,076.00
Total Project Cost	$5,995,836.00

Phase I Appraised Price	
Acquisition	$2,000,000.00
Closing Costs	$80,000.00
Site Work	$85,000.00
Improvements - hard costs	$2,500,000.00
Soft Costs	$375,000.00
~~Capitalized Interest~~	~~$151,200.00~~
~~Developer Fee~~	~~$259,560.00~~
Contingency	$545,076.00
Total Project Cost	$5,585,076.00

Phase I Appraised Price	$5,585,076.00
Purchase Premium Price	$6,415,545.00
Equity Required for 100%	$830,469.00

But wait…how much would I have saved if I didn't use a developer?

Let's compare two approaches:

- **Approach 1: On your own**
  - Self manage
  - Secure financing on your own from day 1
- **Approach 2: Use a developer and purchase at the end of Y5**

Direct Ownership

Self Finance:	
Acquisition	**$2,000,000.00**
Closing Costs	**$80,000.00**
Site Work	**$85,000.00**
Improvements - hard costs	**$2,500,000.00**
Soft Costs	**$375,000.00**
Capitalized Interest	**$151,200.00**
Contingency	**$504,000.00**
Lending Fees	**$56,952.00**
Total Project Cost	**$5,752,152.00**

Owner Financing			
	Sr. Debt	Sub Debt	Total
	National Charter Lender	CDFI	
Loan Amount	$5,176,936.80	$575,215.20	$5,752,152.00
LTC	90%	10%	100%
Interest Rate	5%	5.75%	
Am term	25	25	
Monthly Payment	**$30,263.86**	**$8,861.74**	**$39,125.60**
Annual Payment	**$363,166.32**	**$3,618.72**	**$366,785.04**

Direct Ownership

	Self Own	Developer
Y1	$366,785.04	$648,398.55
Y2	$366,785.04	$648,398.55
Y3	$366,785.04	$648,398.55
Y4	$366,785.04	$648,398.55
Y5	$366,785.04	$648,398.55
Refinance	$5,088,860.00	$6,415,545.00

Have paid down principal

Have to pay a premium

- Developer forces the school to come up with equity or seek financing that covers above appraised value.
- No equity is gained during a lease
- Financing options are limited.
- Schools have a reduced operating budget due to higher lease payments.

How much did the developer make in 5 years?

How much did the developer make in 5 years?

Expenses	
Actual Development Costs	$5,736,276.00
5 yrs of Annual Debt Service	$2,481,316.80
	$8,217,592.80
Revenues	
5 yrs of lease payments	$3,241,992.75
Purchase Premium @ 107%	$6,415,545.00
Equity (remaining principal)	$787,810.00
	$10,445,347.75
Net Profit	**$2,227,754.95**