Facility Financing Options for Charter Schools

Capital Impact Partners

D.A. Davidson

WACSA Conference April 28, 2018
Session Overview

- Introductions
- Facility Considerations
- Financing Options
- How Lenders Evaluate Schools
- School Case Studies
DELIVERING EDUCATION IMPACT TO UNDERSERVED COMMUNITIES NATIONWIDE

$735 MILLION+ FINANCING
235 Charter Schools
240,000 Students

• Financing charters for 30 years
• Acquisition, construction, permanent, working capital loans ($1 - $6 million)
• Expertise working with small schools and large networks
• Mission-driven lender focused on underserved communities
High Quality Schools

Capital Impact’s Guiding Principles For Lending

- College and career pathways
- Supportive environment & culture
- Engaged & Connected Leaders and Staff
- Invest in professional development
- Innovative and rigorous instruction
- Community hubs
D.A. Davidson is consistently among the most active underwriters of negotiated municipal bond offerings nationally and is the #1 underwriter, based on number issues, of charter school bonds nationally.

Source: 2015 LISC Study (D.A. Davidson total includes Kirkpatrick Pettis transactions as Davidson acquired Kirkpatrick Pettis in 2005 and is now a division of D.A. Davidson)
Timeline to Facilities

Planning | Ramp-Up Operations | Facility Development

Today | School Launch | Financial Stability for New Facility Development | Permanent Facility

1 year | 2-5 years | 1-3 years

What You Need:
- Operational sustainability
- Stabilized enrollment
- Audit history
- Healthy cash reserve

General Timeline:
- Design: 6-8 mos.
- Entitlements: 6-12 mos.
- Renovation (TI): 6-12 mos.
- New construction: 8-15 mos.

Source: Pacific Charter School Development
Facility Options

- Lease - school districts, private
- Lease-to-purchase
- Turnkey development (PCSD)
- New construction/build own facility
Facility Considerations

- Timing/growth stage
- Financial
- Organizational capacity
- Stakeholders
What Can You Afford?

• General Rule of Thumb: $1,200 - $1,300 of facility expenses per student.
• 500 students = $600,000 annually for lease/debt service
What Does $600k/year Buy?

<table>
<thead>
<tr>
<th>Property Acquisition and Rehabilitation</th>
<th>Net Proceeds Generated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Cost and Term</td>
<td></td>
</tr>
<tr>
<td>5.5% for 30 years</td>
<td>$7.8 Million</td>
</tr>
<tr>
<td>6.5% for 30 years</td>
<td>$6.9 Million</td>
</tr>
<tr>
<td>7.5% for 30 years</td>
<td>$6.2 Million</td>
</tr>
</tbody>
</table>
# Comparing Types of Lenders

<table>
<thead>
<tr>
<th>Lending Institutions</th>
<th>Traditional Banks</th>
<th>Community Development Lenders</th>
<th>Bond Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan Terms</td>
<td>10-15 years</td>
<td>Up to 7 years on standard products (29.5 years w/ perm loan product)</td>
<td>Up to 30 years</td>
</tr>
<tr>
<td>Loan-to-Value</td>
<td>70-80%</td>
<td>80% - 90% (sometimes higher)</td>
<td>Up to 100% (sometimes higher)</td>
</tr>
<tr>
<td>Fees (include legal fees and closing costs)</td>
<td>1% – 3%</td>
<td>1% – 2%</td>
<td>3% - 5%</td>
</tr>
<tr>
<td>Benefits</td>
<td>Can provide higher loan sizes and multiple products (e.g. lines of credit)</td>
<td>More flexible and nimble; often able to move faster through underwriting &amp; closing process. Familiarity with charter school finance</td>
<td>Provide long term capital, often at the lowest interest rates</td>
</tr>
</tbody>
</table>
# Comparing Financing Options

<table>
<thead>
<tr>
<th></th>
<th>Traditional Products</th>
<th>New Markets Tax Credits</th>
<th>Tax Exempt Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Loan Amount</strong></td>
<td>Loan amounts vary</td>
<td>Typically $5 million + based on cost of issuance</td>
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<tr>
<td><strong>Loan Structure</strong></td>
<td>Terms and amortization vary</td>
<td>Generally 7 years, interest only</td>
<td>Up to 30 years, amortizing</td>
</tr>
<tr>
<td><strong>Loan-to-Value</strong></td>
<td>Up to 90%</td>
<td>Up to 90%</td>
<td>100%</td>
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<td><strong>Benefits</strong></td>
<td>Appropriate for smaller, less complex transactions. Quicker underwriting.</td>
<td>Interest only period; 20%–25% “debt forgiveness”; attractive interest rates</td>
<td>Long-term financing; attractive interest rates</td>
</tr>
<tr>
<td><strong>Challenges</strong></td>
<td>May have to refinance</td>
<td>Property must be located in an eligible census tract; need to refinance after 7 years; complex transaction with higher legal costs; no prepayments; based on availability of allocation</td>
<td>Only the strongest school applicants are eligible, can be difficult for new schools; complex transactions with higher legal costs; locked into longer terms</td>
</tr>
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</table>
More Financing Options than Ever Before

- USDA
- Bank Financing
- Lease-to-Purchase
- CDFI Loan
- New Market Tax Credits
- Bond Financing
Which Financing is Typically Associated with…..

Rural charter schools

Established or replicating charter schools

Diverse & large FRL student populations

Start-up/new charter school

Established schools w/ equity in their buildings

Diverse & large FRL student populations in specific locations

Lease-to-Purchase

CDFI Loan

New Market Tax Credits

Bond Financing

Bank Financing

USDA
Which Financing is Typically Associated with…..

- Rural charter schools
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- Lease-to-Purchase
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- Bank Financing
- USDA
Type of School: Rural schools
Type of Financing: Interim/bridge financing or up to 40 year financing
Why this approach?: Below market interest rates, <4% for 40 years
Worth noting...: Need interim financing source while project being built
Keep in mind...: Longest financing process, can be years
Lease-to-Purchase

**Type of School**
- Start-ups/young schools/some replicating schools

**Type of Financing**
- Leased to school

**Why this approach?**
- Developer identifies site, finances and builds to suit

**Worth noting...**
- Option to purchase at later date at premium

**Keep in mind...**
- Most costly option
Bond Financing

**Type of School**
- Typically for established or replicating schools

**Type of Financing**
- 30-35 year permanent financing

**Why this approach?**
- Interest not subject to taxation = lower interest rate for school

**Worth noting...**
- Not subject to LTV ratio requirement but reserve required

**Keep in mind...**
- Interest rates higher than bridge financing options
Bank Financing

Type of School
- Established schools w/ “equity” in facility

Type of Financing
- Interim/bridge financing

Why this approach?
- Bank interest rates currently low

Worth noting...
- Do not require reserve fund typically

Keep in mind...
- Subject to LTV requirement, need cash or facility equity
CDFI

- **Type of School**: Young, expanding schools w/ high FRL & diverse student bodies
- **Type of Financing**: Provide both senior & subordinate acquisition, construction, perm
- **Why this approach?**: Lend to schools that fit their missions
- **Worth noting...**: Flexibility, sometimes partner, higher LTVs
- **Keep in mind...**: Can be a good source of capital for inner city schools

Worth noting...

Keep in mind...
New Market Tax Credits

Type of School: Schools in distressed communities serving high FRL

Type of Financing: Loan, ~20% portion converts to equity @ end of 7 years

Why this approach? Can make an expensive project feasible

Worth noting... Limited NMTC allocation available, competitive, complicated process

Keep in mind... Complicated legal structure leads to significant upfront fees, long process, many players
How Lenders Evaluate Schools:  
*The Four C’s of Credit*
## Character

### Experience & Trust

<table>
<thead>
<tr>
<th>School Management</th>
<th>Project Management</th>
<th>Students</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Board</td>
<td>• General Contractor</td>
<td>• % FRL, ELL, minority</td>
</tr>
<tr>
<td>• Executive Director</td>
<td>• Architect</td>
<td>• Curriculum</td>
</tr>
<tr>
<td>• Principal</td>
<td>• Project Manager</td>
<td>• Student/Teacher Ratio</td>
</tr>
<tr>
<td>• Finance Manager</td>
<td></td>
<td>• Family/community Participation</td>
</tr>
<tr>
<td>• Teachers</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Competition

**Charter and Academic Performance**

<table>
<thead>
<tr>
<th>Market</th>
<th>Performance</th>
<th>Enrollment</th>
</tr>
</thead>
<tbody>
<tr>
<td>District Schools</td>
<td>Test scores</td>
<td>Growth Trends</td>
</tr>
<tr>
<td>Other Charters</td>
<td>Graduation Rates</td>
<td>Waiting List</td>
</tr>
<tr>
<td>Authorizer</td>
<td>AYP</td>
<td>Retention</td>
</tr>
<tr>
<td>State Law</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Credit

### Financial Condition and Performance

<table>
<thead>
<tr>
<th>Balance Sheet</th>
<th>Income Statement</th>
<th>Cash Flow</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Cash on Hand / Liquidity</td>
<td>• Operating Income</td>
<td>• Operating EBIDA</td>
</tr>
<tr>
<td>• Existing Debt / Leverage</td>
<td>• Net Income</td>
<td>• Debt Service Coverage Ratio (DSCR)</td>
</tr>
<tr>
<td>• Net Assets</td>
<td>• Trends</td>
<td></td>
</tr>
</tbody>
</table>
Collateral

Recourse After Cash Flow

<table>
<thead>
<tr>
<th>Real Estate</th>
<th>Credit Enhancement</th>
<th>Reserve Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Down Payment / Equity</td>
<td>• Guarantees</td>
<td>• Debt Service</td>
</tr>
<tr>
<td>• Loan-to-Value</td>
<td>• Letter of Credit</td>
<td>• Maintenance</td>
</tr>
<tr>
<td>• Appraisal</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Key S&P Credit Rating Metrics

### S&P Charter School Medians

<table>
<thead>
<tr>
<th></th>
<th>BBB+/BBB</th>
<th>BBB-</th>
<th>BB+</th>
<th>BB</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FY16</td>
<td>FY15</td>
<td>FY16</td>
<td>FY15</td>
</tr>
<tr>
<td># of Schools</td>
<td>27</td>
<td>28</td>
<td>99</td>
<td>104</td>
</tr>
<tr>
<td>Enrollment</td>
<td>2,386</td>
<td>2,371</td>
<td>932</td>
<td>806</td>
</tr>
<tr>
<td>Lease adjusted MADS coverage (x)</td>
<td>1.78</td>
<td>1.77</td>
<td>1.48</td>
<td>1.50</td>
</tr>
<tr>
<td>Lease Adjusted MADS as % of revenue (%)</td>
<td>8.5</td>
<td>N/A</td>
<td>12.0</td>
<td>N/A</td>
</tr>
<tr>
<td>Unrestricted days' cash on hand</td>
<td>156</td>
<td>157</td>
<td>138</td>
<td>123</td>
</tr>
<tr>
<td>Unrestricted cash to debt (%)</td>
<td>36.2</td>
<td>32.1</td>
<td>22.0</td>
<td>19.1</td>
</tr>
</tbody>
</table>

*Investment Grade* | *Non-Investment Grade*
Case Study: Pacific Heritage Academy Project
Pacific Heritage’s Fact Set

Location: Salt Lake City, Utah

School Type: K-8

First Year of Operation: 2013

Charter: Automatically renewed annually unless terminated by State Board or School’s Board

Current Enrollment: 427

Maximum Enrollment Allowed: 450

Curriculum: Teaches math, science, reading social studies and writing through “real world” learning units, integrating primary sources and hands on experiences. Focus on Pacific Islander culture.

Facility: 30,194 square foot building on 5 acre site, “turn-key” development project

Future Capital Lease Payments: $564,443 in FY 2018, increasing 3% annually

What type of financing is best suited for Pacific Heritage?
Financing Results – Bond Issue

Size of Borrowing: $7,850,000 ($7,565,000 tax-exempt, $285,000 taxable for COI)

Term: 30 years; Final Maturity September 15, 2047

Annual Debt Service: ~$523,000

Uses of Funds: Property Purchase Price = $6,877,596; Bond Reserve Fund = $537,735; COI = $434,669

Coverage Covenant: 1.10X

Cash on Hand Covenant: 45 Days

Pre-payment Provision: No penalty on any business day after September 15, 2022
Case Study: Envision Education, Impact Academy

Overview:
• $5.9 million transaction
• Financed development and installation of 15 modular units for a new middle school in Hayward, CA (leased from Hayward Unified School District)

Financing:
• CIP $3.7 million loan
• PCSD $1.8 million subordinate loan
• Envision contributed $400,000 equity

Impact:
• Middle school for 360 students
• Supports expansion of successful grade 9-12 program, based on parent demand
• Opened Fall 2017
Case Study: Equitas Academy

Overview:
• Three transactions to support growth of single school into a network of 4 schools
• Financed the renovation of 2 schools, ground-up construction of new elementary underway

Financing:
• $10 million+ in financing (including NMTCs)
• Common structure, partners:
  o CIP – Leverage Lender
  o ExEd – Provided NMTC Allocation
  o PCSD - Developer

Impact:
• High quality schools serving 800+ students (97% Hispanic, 92% FRL)
• Excellent academic performance
• Prepares students for college and higher ed
The Answer Key
How To Plan, Develop, and Finance Your Charter School Facility

Are you looking to build or grow your charter school but need guidance on the process?

Based on our 20-years of experience, and input from educators like you, this step-by-step guide takes you from concept through completion.

Download your copy at www.capitalimpact.org/theanswerkey

Also - 2 Walton Family Foundation Loan Funds:

- Civic Builders’ Facilities Investment Fund - info@civicbuilders.org

- Charter Impact Fund - info@charterimpactfund.org
Discussion/Questions

Stay in Touch!

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