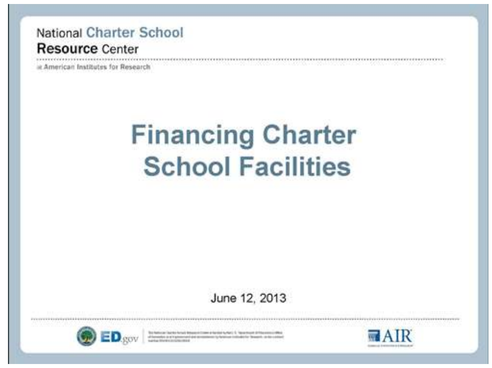
Charter School Facilities Institute: Financing Charter School Facilities

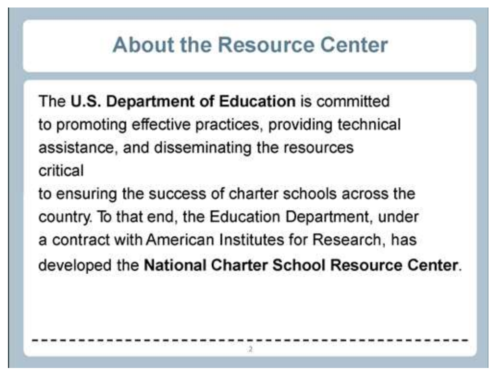
Part 1

TAMMIE KNIGHTS:
Good afternoon everyone. My name is Tammie Knights from the National Charter School Resource Center, and I'm pleased to welcome you to the webinar *Financing Charter School Facilities*. The Resource Center is funded by the Department of Education Charter Schools Program and serves as a national center to provide resources, information, and technical assistance to [support] successful practices in charter schools.



Slide 1

I want to quickly remind you about our webinar platform. You can listen to the audio portion either through your computer or over the phone. If you do join by phone, please mute your computer speakers to prevent an echo effect, and if you were not prompted to enter your phone number, please dial the number that is listed in the chat.



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For any questions you have today throughout the webinar, please enter them in the chat. You will find a copy of the PowerPoint to today's [webinar in the File Share located directly below the chat]. I'm going to turn it over to Josh Kern of TenSquare who is going to tell you more about our webinar series on facilities and introduce our panel.

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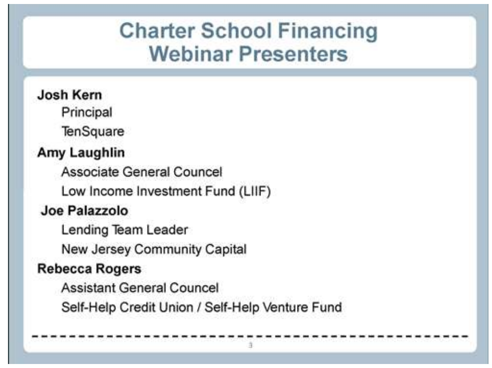
JOSH KERN:
Great. Thank you so much, Tammie. Well, this is the third webinar in a four-part series. The first two webinars were about great spaces. That was two Wednesdays ago, and then last Wednesday we had a webinar about predevelopment and construction management. Again, my name is Josh Kern, I'm with TenSquare. TenSquare is a national organization located in [Washington,] D.C., that supports charter schools through their facility process. And Rebecca?



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REBECCA ROGERS:
Hi. I'm Rebecca Rogers. I'm assistant general counsel [audio skip] of financial institution regulated by a special office within the treasury department. We work to provide financing and capital for a wide range of community facilities.

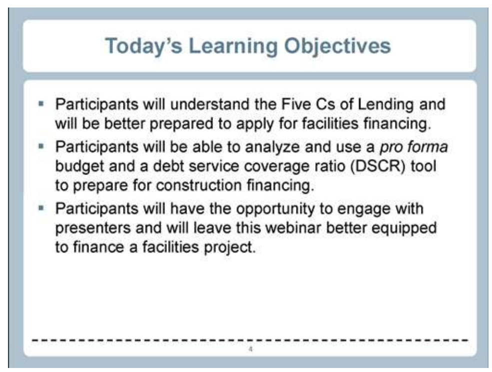
AMY LAUGHLIN:
Hi. I'm Amy Laughlin. [I'm associate general counsel with Low Income Investment Fund (LIIF). LIIF] is both on the east and west coast. We are a nonprofit lender to charter schools and have been in operation for over 25 years.

JOE PALAZZOLO:
Hi. My name is Joe Palazzolo. I'm the lending team leader for Education & Early Care at New Jersey Community Capital. We're based out of New Brunswick in New Jersey. We serve the entire state of New Jersey. We're the largest charter school lender in New Jersey and we're also [audio skip].

TAMMIE:
I'm going to put up a few polling questions. If you could just answer them, and then we'll go over the results. So of our about 80 participants, we have about 19 percent who are school staff members, about 27 percent who are with the charter [audio

skip]. Great, so, again, of about the 82 now who are joined, we've got about 48 percent who are new to the field of facilities, about 37.5 percent who are experienced but are looking to learn about the work of others [audio skip]. Tell us a little bit about your school. Now we're up to about 90 participants. So it looks like we have about 15 percent who are new to the state and about 20 percent who are in the middle of the construction project or building acquisition process. And one more question for you. Of the 90 participants, we have about 40 percent who are in a stand-alone private space, about 20 percent [audio skip]. So thank you for telling us a little bit about yourselves, and we will continue with our presentation.

JOSH:
So we have three main learning objectives today. First, that you will understand the five Cs of lending and will be better prepared to apply for facilities financing [audio skip]. And the third is that you will have the opportunity to engage with presenters as there are three people plus me on the panel. And you'll leave the webinar better equipped to finance a facilities project.



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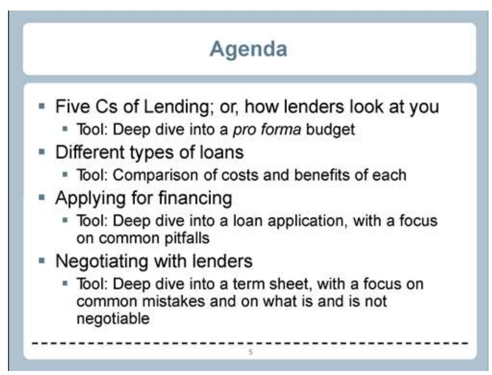
So, the agenda items for today, again, we're going to cover the five Cs of lending, how lenders look at you, and we have three lenders on the panel here. We're going to cover the different types for each of these four areas that we're going to be using [audio skip].



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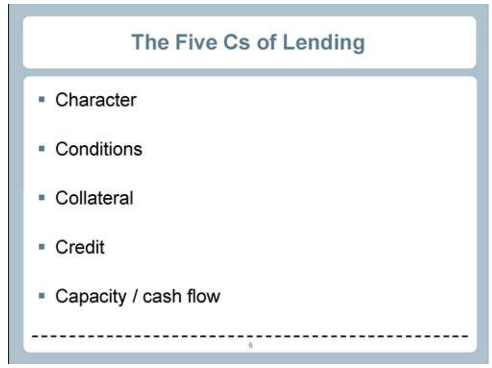
REBECCA:
Hi. I'm going to cover with you the five Cs of lending. This basically is a model that lenders have used for decades to really understand [audio skip] for schools to use regularly to do your own self-evaluation to take a critical look at yourself in your operations, whether you're involved in a financing project or not. I also wanted, in another area, but there should be a plan for overall improvement of each of these areas that we're going through.



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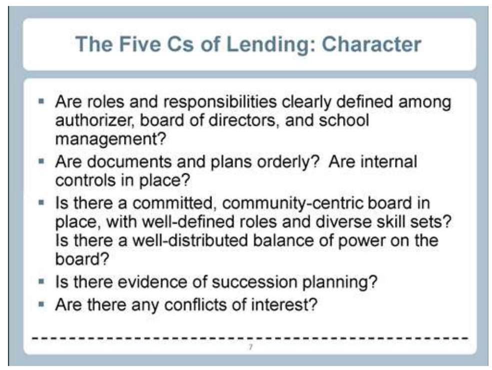
The first C is **character**.
While a lender really does care a lot about the financing or the financial performance of a school, it's equally important to see strong management of a school. We'd like to know that you have clear roles for all the people managing the organization and that you are under a CMO [charter management organization] or EMO [education management organization] or other outside contract to do some or all of your management. We're definitely going to want to understand that and how it impacts your school's financial and organizational performance.



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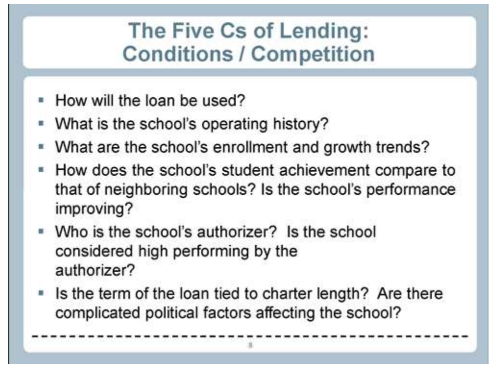
We want to see a strong board. Often when there is a visionary or a group of visionaries who found a school, sometimes the weight tends to lean a little too much to the administration side. We like to see [audio skip] having an attorney, a skilled attorney, on your board and having an accountant on your board or someone who is skilled in business. We want to make sure that we are aware of any conflicts of interest between members of the school administration, parents, and board members and, again, that there are strong checks and balances within the school. And we also like to see that you wisely use professional resources so that you are willing to retain [audio skip].

[The second C] is **conditions** and **competition**. This really tells us a lot about what is the substance of your school. How is it established? What is its history? What vision inspired the school? What's your organizing principle? How has your growth been? If you're a brand new school, what are your plans for recruiting sufficient students to open? If you're an existing school, how have your growth trends been and [audio skip] your results? Specifically, if you're an existing school, what is your academic performance? Are you achieving both the minimums under the No Child Left Behind statute but also other stronger goals for really meeting the needs of your constituents? And lastly, sort of what is the environment for charter schools in your area? Is there a strong state support for charters?



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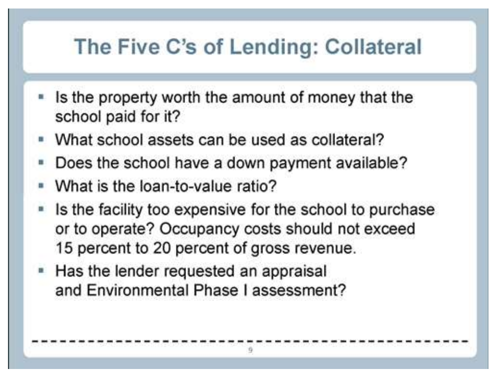
Obviously, when we make a loan to a charter school, we're very interested in financial performance and getting paid back under the normal circumstances. But we also want to know that we have strong security for the loan, so **collateral** is the important next C. Almost universally we're going to be looking at real estate collateral primarily. So we want to look at things like—Is it a special use property? How generic is the property? Is it well located?—compared to the size of the loan. Not all loans have a single source of collateral. Sometimes schools bring several pieces of either real estate or other property that can serve as collateral for the loan. They also can bring and have brought in many instances guarantees from a supporting foundation, from a high net worth [inaudible].



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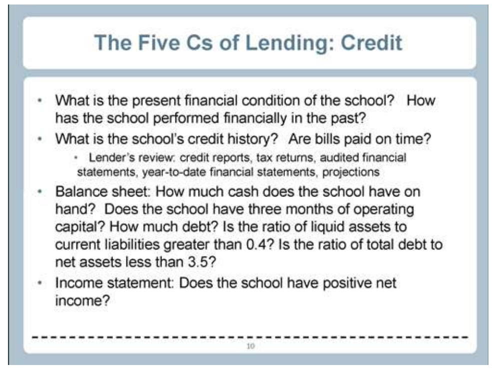
Often, if you work with a CDFI [community development financial institution] fairly early on, we can be very, very helpful in cost engineering your project with you, looking at all areas of the budget to see where there can be some savings. So if you've got a tight loan-to-value ratio, we can often be very helpful in finding some space there by asking some critical questions for a property. And if it has specific deadlines, we want to know that we are—what our timing deadlines are. So that's going to be important for us.



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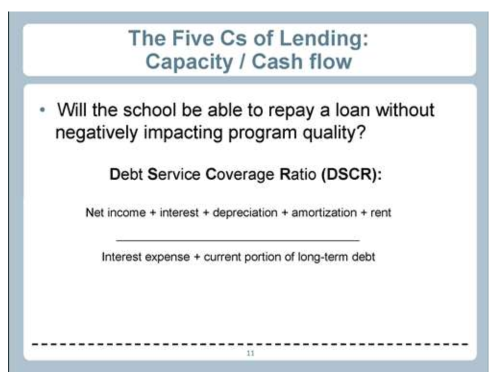
Moving onto the **credit** C, this is essentially your financial performance. What have been your traditional financial results? If you're a new school, the health of your budget, the real strong analysis that has gone into your initial budget is going to be very important. Where are your numbers coming from, and have you been getting your payments from the state in your other sources of revenue, and how have they been used? Are you paying your bills on time? This goes very strongly to the question of management. Do you have a nice organized financial management process? Are you using software? Are you using [audio skip] cash reserves? Do you have some cash on hand to meet emergencies? That is something that arises routinely with charter schools—that they are able to meet their regular bills, but if something unusual happens, that [audio skip].



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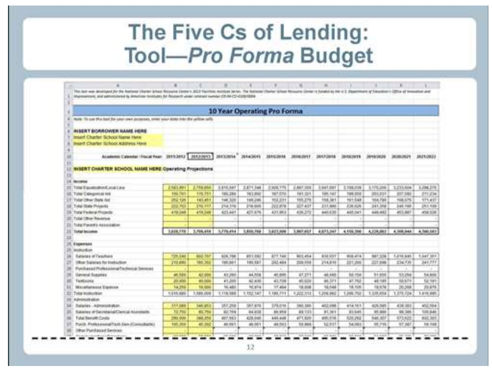
And that leads to our last C, which is **cash flow**. That is, what is the **capacity** within your normal operating budget to carry this project? We use what's called the *debt service coverage ratio* [DSCR], which is a look at your total revenues from all sources divided by, or over, all of your expenses. You have to pay in-depth service for the proposed project. And it's sort of a sliding scale. You can adjust things up and down, but basically what assumptions are there about how much your debt would cost, principal and interest payment, plus any deposits that the lender is going to require into reserve? And do you have a cushion above that in your operating income? Are you able to pay all of your normal expenses plus carry the debt service and have a little bit of cushion? There is no [audio skip].

And I think Joe is going to now look very specifically at a pro forma budget and show you exactly how a debt service coverage ratio in more detail is calculated.

JOE:
Thank you, Rebecca. So we wanted to show you a real example of what we look at in our underwriting when we calculate debt service coverage ratios. So up on your screen you should have a spreadsheet, which is the actual spreadsheet that we use at New Jersey Community Capital.



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So we've taken the name of this particular charter school out because we don't want to put that out there. But what you'll see, right up top here, is we look at the charter school's income, that's these line items right here. And a little bit above that, you'll see that when we look at this spreadsheet, we lay it out in academic calendar/fiscal year. So this Column C, these are the numbers that we input directly by hand, and for this particular transaction, they accounted for all of the numbers that we already knew from the prior year. Some of these numbers are input by hand, some of them are multiples of the numbers in yellow cells.

Over in the income area, you'll see we pull these numbers directly from your audit. We'll talk a little bit about the audit in a few slides. So all of these numbers are directly reported from your audit. In the next category, you have [inaudible] is we've decoupled your rent payments that you pay for your space from what some schools report in their administration or they might report it in their support services. We've gone through and extracted that number and made its own line item right here. And what we get here is our net operating income and then your year-end fund balance.

In other words, how much money do you have at the end [audio skip] is sort of a general catchall. This is your landlord, this is our borrower. This is where we're making the loan in this case. So we look at the income they receive from the school. Lease payments from the charter school, which should match that number above. And [audio skip] special events, that might be special events that the [inaudible] on behalf of the school and any other sources of revenue.

In this particular example [audio skip], we do believe that they're going to have to incur some accounting fees after owning the building for so long, so we've put a placeholder in there for that.

And then just like any other mortgage, just like we did above, we find out what your operating income is and then [inaudible] has a second mortgage and then we look at how much money the borrowing entity has after all those payments are made? We use the, they use the same formula that we just talked about, and it creates this debt coverage ratio.

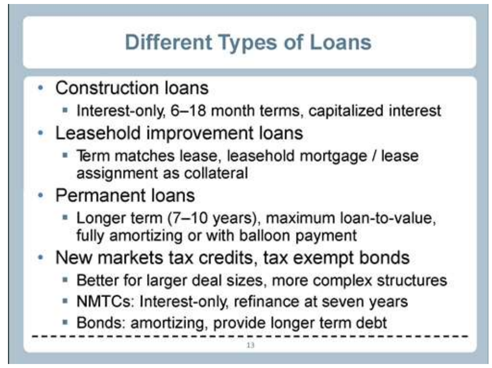
Typically, your debt coverage ratio for a CDFI has to be between 1.05 and 1.2 depending upon the lending program that [audio skip]. I just want to call attention down here at the bottom to another calculation that each CDFI is going to look at. And that's the amount of your budget that you spend on facility costs. I think nationwide the number might vary a little bit. It might be between 12 percent in some places in the northeast and [audio skip].
So in this particular transaction that we captured in

this spreadsheet, you see that the amount of the budget spent on facility costs is below 10 percent, so for us, we feel like we're doing good for the starter school because we've lowered their cost of occupancy [audio skip] spreadsheet. The more of this information you can prepare before you go to your lender, the better off you're going to be negotiating with your lender. And then the other thing to remember is just because you've prepared this and you put quite a bit of time and effort into preparing this, when you bring it to your lender, don't be surprised if your lender goes and changes some of the numbers. [Audio skip] change your projections a little bit.

TAMMIE:
Thank you, I just want to interject with question that came up in the chat about the debt service coverage ratio. If, Joe or Rebecca, if you could talk about what the minimum would be or if you see a range of what the minimum debt service coverage ratio would be?

REBECCA:
Well, as Joe mentioned, about 1.05 is going to be skating into fairly thin territory. Again, because it is often the case that charter schools are surprised by expenses during the course of their year. So if we see a cushion of a 1.15 debt service coverage ratio or a 1.2, that's a healthy cushion to let us know [audio skip] almost never lower.

AMY:
Great. I'm going to talk a little bit, for a couple of minutes, about both the types of loans that are available to charter schools as well as the types of lenders that charter schools can reach out to access this financing. In terms of types of loans, it really depends on your project. Is that it can [audio skip] just a typical construction loan, this is geared towards a loan where you're acquiring the facility that needs either ground-up construction or substantial rehab. Interest is generally capitalized during the term because you obviously, it's unlikely you'd have an operating business [inaudible] and some improvements are necessary in order to make it habitable as a charter school.



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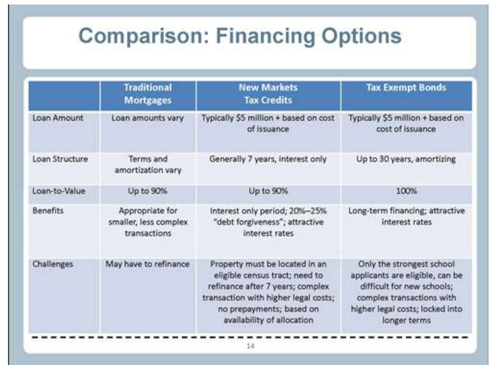
So the difference is between the construction loan and the leasehold improvement loan is really from a lender's standpoint, a lot about the collateral that we'll be getting as, I think Rebecca talked about earlier. In a construction loan, we'll be looking for a lien on the facility, as you'll own it, and in a leasehold improvement loan, the collateral we'll be looking for will be a letter [from your landlord].

After you complete construction or perhaps if you are acquiring a facility that doesn't require construction, you'll be looking for a permanent loan. This is a longer term loan that will enable you to pay principal down over time. And that principal will get paid down based on an amortization schedule, which may [audio skip] refinance after a period of time.

I also add in, we'll be talking a little bit more about this on the next slide, but new markets tax credits and tax exempt bonds. These are more complex financing structures. But I wanted to note them on this slide as well because they are situations where you could get construction financing. I know at LIIF and probably some of my partner organizations here we might be willing to provide it as one loan where you have a construction loan that, once you hit certain requirements and your construction is complete, it can automatically transition and convert into permanent financing.



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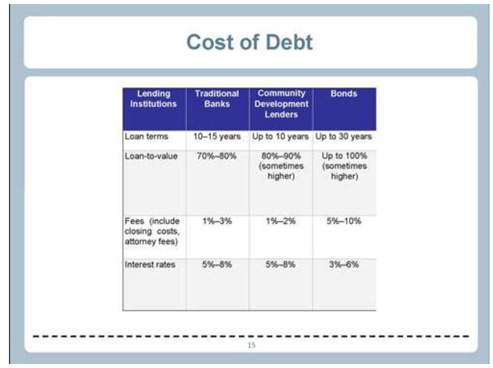
So if we move to the next slide, we wanted to take a moment to just compare what's accessible for charter schools, and you can go to your community lending institution or CDFIs to access those types of loans. They're really appropriate for any loan size. And I would say one of the challenges with it is a lot of organizations are limited in the terms that they can provide. We generally see seven- to 10-year terms on these. [Audio skip] enormous benefits for charter schools and other community facility projects. It was put into place to help encourage private investment into low-income or distressed communities. Your project and the location of your project would need to qualify, but the key benefits for this are [audio skip] that's the term of the loan. And the interest rates are generally lower than what you can find on the market.

Another major benefit of new markets tax credit transactions if you, depending on the structure that you use for that particular project, there is a potential for debt forgiveness at about, I would say 20 to 25 percent at the end of the term. So those are two enormous [benefits]. It is only for seven years, so there would be a need to refinance before you can fully pay down your principal. And it is a complex transition, so there are definitely high costs that come along with it. So therefore, we generally don't recommend this type of transition for loans that are lower than about $5 million. And the transaction costs are generally paid out of the proceeds of the loan, but it is still something to consider because it increases the amount you need to borrow to secure allocation.

And then the last one I want to talk about is the tax exempt bonds. These are also similar to new markets. These are complicated transactions. They’re expensive to close, so we again recommend a threshold of roughly $5 million so there might be [audio skip] so we’re seeing terms of 30. I've even seen as high as 35 years. So you are able to pay down your principal completely during the term of the loan, and so there's no need to refinance, which is a key benefit for this. Interest rates vary. Right now I know at least in California the interest rates are quite favorable for bond financing.



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Then with bond financing is really since, you know, you're really going to the market in terms of finding purchasers for your bond. These could be available to really the strongest schools, the schools that have been in operation and have a strong operating history and are strong both from an academic as well as a financial perspective.

The last thing I wanted to talk about before turning it over to Joe is the type of institutions that you can reach out to for financing. So obviously there are traditional banks, and more and more we've seen traditional banks becoming a more likely [audio skip] they make sure this is a bank that has lent to charter schools before.

I know a lot of the banks that we see our charter schools out in California working with, they really want to be able to work with charter schools, and they will go so far as to take it to their credit committee, and then they might have some challenges at that point. So if you're going to go down that path [audio skip] financing.

I think as Rebecca explained, we are all community development finance institutions here. So we're community development lenders. We're nonprofit lenders, and we do a lot of work with charter schools for LIIF. About half of what we do is work with charter schools. So that's another opportunity for you to access debt. One of the, a couple of the benefits that we have is, you know, we understand your revenue streams. We know charter schools very well. We're, at least for LIIF, our overall mission is poverty alleviation, so we tend to work with charter schools that serve low-income populations. So you want to make sure that if you're reaching out to community development lender that you know if they have any thresholds in terms of the free and reduced lunch population at your school. And then obviously bonds—in order to access the bond market, you'll need to go to a [audio skip].

JOE:
[Audio skip] applying for the loan. And as you'll see here, there's a preapplication period that we've seen go anywhere from three months up to three years. And there's some key [audio skip] traditional mortgage lender, residential lender. We're not going to require you to give 20 or 30 percent for your down payment. We're typically going to look for about 10 percent. Then there are some special financing programs, which we just covered, where that can go down as low as zero percent, but just remember, that's not an indicator of financial strength. So your lender is going to kind of take a leery eye towards that. They're going to want you to have some skin in the game.

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And then the next bullet point there about your professional project capacity. This is when you get to build your team. So this is going to be your attorney, your engineer, your architect. This is going to be if you have an owner's rep or a real estate consultant. So this is not a time to call in favors from your friends or from family members. We have an example up in New Jersey where we went through the entire loan underwriting process, got an approval for a pretty complex transition, and the closing [audio skip] that delayed the closing by an additional two weeks. So you want to be aware of the professionals that you use and make sure they have experience. And on that point, and this is the finance [audio skip] seminar for an attorney to learn what a charter school is all about.

The next set of bullet points there about the key documents to prepare—all of these documents, they speak to your ability to repay the loan and to your capacity as an educational institution. And we'll talk about some of these on the next slide, but the financial information is key and I just [audio skip] going to tell us quite a bit about how you're going to manage our loan if we decide to give you a loan. We're going to look at the stability of your scores of income. I know a lot of it is government related. It's New Jersey. It's local and state revenues. But we're going to look at the stability of your sources of income and the efficiency that you have in spending that money.

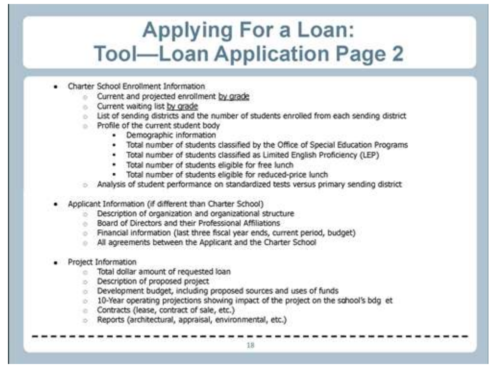
Our applicants—so you can take a few minutes, maybe a few seconds rather and scan through some of those bullet points and some of that text. There's quite a bit there on the page. The first bullet point refers to the rest of this particular document. We don't have the full document up here; it's five or six pages. But we know that this is a U.S. [audio skip], and I think we've all worked with that guarantee program up here, so many of your CDFI lenders will find ways to use the guarantee to provide credit support for your loan.

Slide 17

The second bullet point about your organizational materials—you're going to want to make sure this information is together and you have it organized, articles of incorporation, bylaws, and 501(c)(3) determination letter. If that’s difficult for you to find, if it's difficult for you to generate, or if you just don’t have it, well that speaks a great deal about your attention to detail. And as a lender, if we receive all the other due diligence documents but we don’t have this basic information, and it's happened before, that’s going to tell us quite a bit about how you're going to manage our loan.

Our loan documents may require you to submit quarterly reports. This may be an issue following up with this borrower throughout the year because they don't have their basic information together. I did want to bring that up because we have seen that on several occasions in New Jersey. Plus, just in passing, you're going to want to have this information together anyway because I know a lot of charter schools receive [audio skip] come take a look and just write you a check. They're going to want all of your background documentation, all your organizational materials as well. So you do want to have this together in one safe spot.

The final bullet point there is about your financial information. Again, this is the minimum financial information. This really shouldn’t be strenuous to put together. You’ll see there audited financial statements for the last three years. If you’ve got three years of history, well, you should have your audit in New Jersey. It's your state-approved budget. You may have something different in your state.



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This is the bottom part of that page that we have our charter schools fill out, and we just want to hit on a couple of these. Again, look at that first bullet point about enrollment information. There are several reasons why this is important. First, we're going to want to know the makeup of the school that we're helping out. As CDFIs the investors and our funders that we're helping those students with our loans. Again, this is also a check on you. If we ask you the free reduced price lunch numbers that you have at your school, and they are drastically off from what is reported at the state level, then that might be a cause for discrepancy in our underwriting and a cause for us to take a [audio skip].

But if you look into the sub- subbullets, the demographic information, we're going to ask you for the total number of students classified by the Office of Special Education Programs. That's your special needs students. I know historically, throughout the nation really, charter schools have underreported their special needs students. So I think it's really time for charter schools and I know we've all been [audio skip] for special needs, which made them one of the highest percentages of special needs students population in the entire state regardless of traditional versus charter school. So it was a good group for us to work with.

That second bullet point there talks about your applicant information. It's only relevant if the school itself is not applying for the loan. So this is if you have [inaudible] applying for the loan or special-purpose entity applying for the loan. All the points I made in the prior slide are the same. So if you don't have all this—the reason why we're looking at some of this enrollment information, the number of students you have and your waiting list, is because, just to be a coldhearted banker for a moment, students in seats equal money. That's your cash, that's your income, that's your revenue. And if we're making you a loan, we want to make sure that not only are there students sitting in the seats to pay our loan back but that you've got [audio skip].

AMY:
[Audio skip] is once you get all the due diligence in and you step up the basic structure of the loan, how do you negotiate terms and conditions? One of the things that we've noticed is really important and really valuable is making sure that everything's in writing even before you get to the documentation phase. There's a lot of discussion that goes on throughout the time when the due diligence period and [audio skip] a letter of interest or we also refer to it as the term sheet and then the commitment letter.

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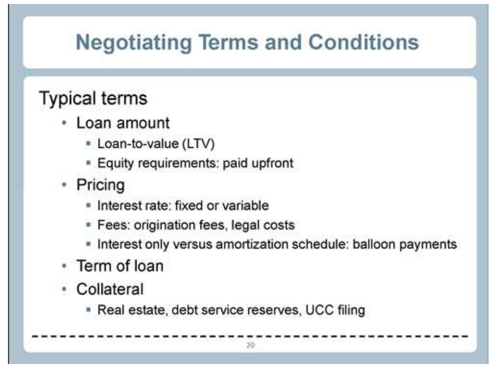
The letter of interest is preliminary. This is really at the early phase when you're talking to a lender. And they're essentially, they're preliminary, they're negotiable. And it's prior to underwriting and credit approval, so this is the time to make sure that you are all on the same page in terms of, and we'll go over the various things that could be in there, but in terms of the terms and conditions for your loan.

In contrast, the commitment letter is already agreed-upon terms. This is after lender has received their full credit approval, and it really should be the basis for your legal documentation as you head to closing. [Audio skip] concerned about what's the interest rate? And that's a very important feature, but there are so many other things that you should also be focusing on in terms of the terms that a lender will be providing.

So the first thing is loan amount. How much can the lender provide? And what is it driven by? For a lot of institutions, it will be driven by a loan-to-value, you know, we can provide 80 percent, 90 percent of the value of the loan, and the rest needs [audio skip] may to go up or down based on the appraised value that comes in. So important things to consider and make sure you understand.



Slide 20

Pricing—the interest rate, critical, but is it fixed? Is it fixed during the term of the loan or is it variable? And if it's variable, does it, could it change from year to year, from month to month? These are things that, this is a risk that you or the financial institution may be taking throughout the term of the loan. So it's important to make sure [inaudible] other sort of reports important that you know and that they're in your budget. Also, is it interest only? Is there an amortization schedule? And as we talked about before that means that there's a schedule by which you're paying down principal during the term of your loan. That's important for you [audio skip] before you pay down all that principal.

Collateral, I think as Rebecca touched on, is really important. Is it real estate? Is it some type of a leasehold mortgage? Do you have the right provisions in place in terms of your lease with your landlord if that's the case? Are there other debt service reserves, building reserves that you need to be [audio skip]?

I know we talked about debt service coverage ratio, but there are also other financial covenants that a lender will require on an ongoing basis during the term of your loan. So this is really critical for a charter school to understand because it will drive how you need to operate your business. You'll need to manage your business from a financial standpoint. [Audio skip] leverage requirements, liquidity requirements. These are critical to make sure that you understand, your CFO [chief financial officer] or key financial representative understands them, and that you feel like they're reasonable and that you can meet them.

Slide 21

Other reporting requirements—these are things that charter schools are generally doing but it is important that you know what's required to make sure that you have internal capacity to manage this on a regular basis. Audits, interim [audio skip].

Part 2

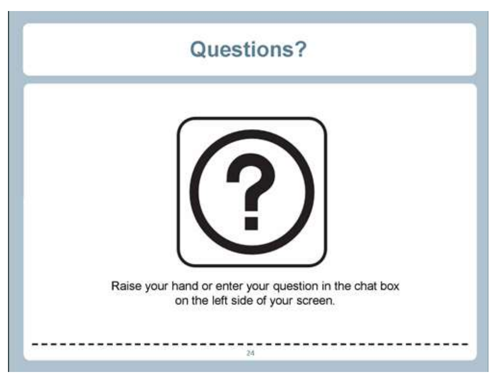
Other closing conditions—this is really critical for as early on as possible that you make sure you understand what is necessary, what you as a charter school need to do up until, to get to closing because the last thing you want is to hit the closing day and realize you didn't get an appraisal and that's going to take another six weeks and now you're closing is going to be delayed. So any sort of reports [audit skip] is right and that we have somebody looking over all the plans and specs and make sure everything is set to go. Construction readiness, if you had your contracts in place, your permits, anything else to make sure that at closing you're ready to begin your construction project.

And also, I think we touched on this before, but closing deadlines. If you have a closing [audio skip] to make sure you're ready to open the school up that fall. That's really important and critical that you and the lender are on the same page with that and that we're all managing to that because again, that's a deadline that we all should be aware of and we want to make sure that we can meet it.

JOSH:
I hope you enjoyed the presentation and learned a lot. And now we're going to go into our question and answer phase. So with that, we'll just tee it up for the first question.

Slide 22

TAMMIE:
Great. We've had a lot of [inaudible]. Can you each talk about some of the standard obstacles that you see schools run in to as they're applying for financing?



Slides 23 and 24

REBECCA:
In thinking about that, I would say for me coming as the lawyer on the panel, that oftentimes what we find is that a school that is [audio skip] or a lease that has escalation clauses and all the sudden it's going to be a lot more expensive than they were prepared for. Or it could be a construction contract

or an architect’s contract that has clauses in it that they don’t read and understand. This gets back to my point about having, being willing to engage very skilled professionals, strategically in a cost effective way to give you the right support at the right time, whether it's in the financing process or especially for some of the schools that we encountered well before the facilities [audio skip] clauses that raise the cost of those obligations.

The other thing that I would say and really emphasize is just being careful of conflicts of interest, especially in schools that are the brainchild of very [audio skip] undertake a multimillion dollar financing project. You're going to need to be careful about conflicts of interest, especially financial conflicts of interest, between the school and, say, board members or other people close to the school.

AMY:
I think I’ll piggyback off that but in the sense of, you know, you want the right support. We find that [audio skip] getting the right development team in place. And I can't stress enough the importance of having the right development team in place. You know, charter schools are in the business of educating. That’s what they excel at and what they do best. But a real estate development project is so entirely different than that. And so making sure—and capacity also at a charter school can be limited.

It's, you know, can take on a finance [audio skip], you know, an owners rep to save money, and yet in the end this could be the best money that they’ve ever spent. So really making sure that in a cost effective way, of course, that you're getting the right development team in place whether you have internal capacity, and you have someone internally whose job it is and has the expertise to help you navigate this project or externally you do that. We can't [audio skip] that you have the internal and external resources to manage this project, both on the construction side as well as the financing side as well.

JOSH:
And just on that one point, last week’s webinar was entirely dedicated to the planning, setting up the team, making sure you had the right, just about the very nature of what they do [audio skip] don’t have the capacity to do this internally and really need to have the right team in place to help manage the project. So, please, if you weren’t part of last week’s webinar, please refer back to that presentation for more information about the planning.

JOE:
I think there are probably two things that I see, and they’re somewhat related. Number one, some schools have unrealistic plans and number two, sometimes schools jump the gun. So [audio skip] you can access that school that’s 10, 11, 12 years old. They can access a different type of facility. So making sure you're looking for the right space on a continuum is important. If a school’s got one year of successful operations underneath its belt and they come to us looking for a $12 million loan, your school is not ready for that yet. You’re not financially ready.

And then, I guess, that also relates to being unrealistic. If you're in an urban setting and space is at a premium and you want to buy half a city block and knock down some of the buildings and put up a big football field in the middle of the city or an equestrian race track, which we’ve heard. That’s not going to happen, so we’re not going to have that conversation. But if you want to [audio skip] would be a very nice space for you and your students.

TAMMIE:
Great. We had a question about the prequalification process and advantages schools might have in planning if they can get a prequalified letter from a lender. Can you talk a little bit [about prequalification]?

AMY:
You know, we don't do that. It's, I think different from your traditional mortgage process. I'm not sure it's, banks might. But what we do that might be helpful, and I think it speaks a little bit to what I was talking about in terms of the term sheet phase and the commitment letter phase. We do our approvals in two phases. We do a preliminary approval to get us to the point where we can issue a term sheet, which lays out a lot of the terms and conditions that are obviously conditions on final approval and then the commitment.

[Audio skip] if it is a priority to, and we do have some charter schools generally the charter schools that we've worked with. A lot come to us and say, we need to see your term sheet. We need this to further the project. And that is something that we can do for them. It's nonbinding. It's a term sheet. It's a letter of interest [audio skip] further their project or give them a sense if financing is possible. That is something that we can provide, and we can turn it around pretty quickly.

REBECCA:
And I think for us [audio skip] to help work that we [audio skip] phase.

JOE:
Your architect or your engineer or your [audio skip] that's what CDFIs do. So if you come across a question from one of your professional service providers that you just don't know how to answer it

or what the, what the scope of the answer might be, well, come and ask us the question, and we'll try and help you out.

REBECCA:
And unlike, I thank a mortgage lender, our first answer on a prequal[ification] letter or first answer on a term sheet is that it's not a static one answer, one question. It's an organic conversation. So it's a lot about [audio skip] to get it right we like to get as much information as possible, but it's not a static conversation. It's a much more organic conversation in a commercial facilities financing setting then it would be in a mortgage.

JOSH:
And I would strongly recommend that someone on your team internally is well versed in pro formas and working on facility financing deals so that there's a person on your team, whether it be the project manager or owners rep who can help interface with the lenders.

REBECCA:
And stability.

TAMMIE:
Okay. Maybe first can you talk about the smallest school that you've ever financed? Is there a magic enrollment number at which point a school becomes more financially viable? And do you have a sense of how big should a waiting list be?

JOE:
Yeah. The smallest school we've worked with had 87 students, which I think is pretty small. The largest had 250 and 350 students. I don't know if that's what you all see. That's what we see. In terms of a waiting list, look, if you've got 300 students, 400 students, we'd all love for you to have

300 or 400 students on a waiting list, but we know that's not realistic. In most cases that's not realistic, but if at each grade level, if you had kindergarten and you go through let's say 12th grade, we know you're going to have a larger waiting list at the kindergarten level and a smaller waiting list as the grades move on. And that's just the way this will pan out because it's the way the schools break up traditionally.

So I don't think there's a magic number. Just make sure you have a substantial waiting list where we would expect it. So again, if there are 30 students in kindergarten [audio skip] and maybe 27 students, well, we want to make sure you're actively out there recruiting students from the local district or wherever you recruit your students from.

REBECCA:
And I think a part of the answer to that question is also what you want to finance. So it doesn't matter how small you are as long as you're not trying to build a [audio skip] location and the nature of the market and you have small school and you have a vision for growing, or you just say this is where we want to be. We can perform our function in this space. So it's a space-to-student- relationship that's very much what are your expectations?

AMY:
[Audio] picture that we're looking at. So if you're, if you have a track record of very strong student retention year over year, and you have a small wait list that is very strong, active, you're checking in with those wait lists that they're still active on the wait list, that's one picture versus the situation where you lose a lot of students year over year. Your wait list is very big but you haven't checked in on it in a long time. I just want to give you a sense that, it's not the only [audio skip].

JOSH:
[Audio skip] I mean more important that the wait list, I would say is hitting your enrollment targets.

TAMMIE:
Shifting gears to the actual loan application, we had some questions about who applies for the loan, and when Joe was talking about friends of the schools applying for the loan or demonstrating support for the schools through grants.

JOE:
I think it depends upon the transaction and probably it depends upon the laws and regulations in your state. When we do larger financing a new market tax credit or [audio skip 8] that is because in many jurisdictions when a charter school closes, not that we're planning for you to close, but we do underwrite to a worst-case scenario, when a charter school closes its assets then could be transferred to the state department of education or the local [audio skip] and has the loan and the debt obligations, then the assets wouldn't necessarily go away.

The transaction [audio skip] and if it's a school business administrator that we talked to and we talk to the people on the board. We talk to the principal, the founder. And we have really great conversations, and the SBA submits the loan application, maybe it's for a leasehold improvement loan, maybe it's for a construction loan.

REBECCA:
[Audio skip] whether it's an outside person or project manager who is taken on to have that conversation with the lender or a specific person within the organization. The CFO is typical or the executive director or the chair of the board. Those are the three that we most often see.

AMY:
[Audio skip] applying for the loan, but who should be the owner of the real estate like you were discussing. In certain states, and I know that this is the situation in California, there is state revenues or [audio skip] or it's the real estate so that you can structure the loan so that it is still a lease agreement. And that you can still access that revenue from the state. And that's something that your legal counsel can help you navigate or even, you know, in conversations with us, your lenders, can help you think through in terms of how can you make sure that you’re able to [audio skip].

JOE:
[Audio skip] or if you’re getting a developer, a developer consultant. Well, have this conversation with them. Say this is the project we want to do, do you think we should have [inaudible] as the owner of the building or should we own it? What have you seen in your experience?

TAMMIE:
Great, that brings us to another question regarding sale versus leaseback of a charter school property [audio skip].

JOE:
We support it at New Jersey Community Capital. Again, we’ll say this a lot. It depends upon the situation and the transaction itself. We did a rural school, yes, there are rural parts of New Jersey. People don’t believe that. We did a rural school up in northwest New Jersey where we made the loan to the developer, and the developer when the project was over [audio skip] operating budget spent on your occupancy costs. We had projects come to us that were in our more traditional zones and the more urban areas that were developer

leasebacks where over the course of the 10-year operating pro forma, the developer was accruing [audio skip]. In the CDFI world, we're trying to put more dollars back into educating students, not paying for your rent or for your lease. So we do say no to those transactions if they don't fit the goals that we have.

REBECCA:
And that goes very strongly to making sure you have someone reading the contract and reading the lease proposals and the developer agreements very carefully so that you know exactly what you're signing up for.

TAMMIE:
Applying for those.

AMY:
New markets tax credits is an award from the CDFI fund as I mentioned. It was put in place to encourage private investment in low-income communities.

REBECCA:
And I should interject…

AMY:
Yes...

REBECCA:
Timeframe, really when…

AMY:
Oh, when a school should—so I would say that what I was going to say next is that essentially the CDFI fund grants this [inaudible] allocation authority to various entities we refer to as allocatees across the country. So those [audio skip 48] on average you should expect a three- to four-month closing

time frame. These are complicated transitions. Things always pop up. And so I would say even though closing takes three to four months, making sure you have those tax credits in place six months ahead of time is never too early [audio skip] it's usually beneficial.

So you have a lot of charter schools [audio skip] community facilities and a project in general trying to access this. And so it is never too early to reach out to a new markets credit allocatee or a potential allocatee for the next round of awards to make sure that you’re on their pipeline [audio skip] together for the next award, which isn't even going to come out until April of next year. I know that allocatees over the past few years are listed on the CDFI fund website. You can look there. You can see who historically has been an awardee of new markets tax credits [inaudible].

REBECCA:
I will say Self-Help as it often is the wingnut in the new markets market. We structure the investment at one level above the schools project so we don’t do an investment in the school itself. For us, it is a normal source of lending funds. So it follows our normal lending process. So there's not an additional time or complexity for the borrower. We have slightly different terms that we bring to our new markets lines so I think a little bit faster than other folks.

JOE:
Our process is very similar to what Amy described at New Jersey Community Capital. Again, emphasize not that it is a very competitive program, so the amount of awards that each of our organizations gets has been decreasing or we’d be getting it every other year, every third year. To Amy’s point, we’re probably oversubscribed in our new markets pipeline by [audio skip].

TAMMIE:
[Audio skip] in general, be it from organizations like yours or from traditional banks.

JOE:
I think never be afraid to have a conversation even if you just want to call a CDFI and say I'd like to have [audio skip]. We put on the slide that your preapplication period could go from, I think we put three months to three years, and that's the truth depending upon the complexity of your transition and your ability and your veracity in putting together a project team. We've seen attorneys that have realized this. But I think once you get to the term sheets, the one point I would make is we give you that full list and we went over those two slides that has all those different bullet points. If you give us 60 percent of that list, week one, look if you're an early stage school you don't have three years of history. Once we get the information, I know, we don't let it sit on our desk at New Jersey Community Capital and I know a least we do it in this direction. Or almost as importantly is a quick note. Just tell, you know, we can't do this [audio skip].

TAMMIE:
[Audio skip] brand new schools that are applying for financing or that need facilities, how do you assess their financial viability?

REBECCA:
I think for us that it's a unique relationship with a brand new school. I know [audio skip] how healthy is their enrollment up front. What stage of the early stage are they in? Are they sort of two years from opening? Are they one year from opening? I think the other, so I think it depends a lot on management, depends a lot on the leadership team that's in place. And then I think it's depends very,

very much on [audio skip] workable space possible.

And that often is leased space for the first few years. To go out in the leasing market sometimes you can find a lot more competitive rates for leased space. But the least expensive, least glamorous, most serviceable space you can get into to match your enrollment with a little space for growth is [audio skip].

JOSH:
One is there's a lot of uncertainty for the school when it's first starting up. And there are things that you’re projecting that you may not know for certain. And so being in less expensive space allows for some of those unknowns to turn out to be not as good as you had hoped and you can still be okay. The second is that you want to be saving money for your long-term home. So [audio skip] you need to have some skin in the game for the long-term home. And that skin in the game is really the savings in your first few years. So as much as possible you want to find a home facility in your early years that is very affordable based on conservative [audio skip].

REBECCA:
And then your long-term home in three to five years is where you really can commit. Put down your permanent roots.

JOSH:
Right.

AMY:
Right.

TAMMIE:
And the question around the roles that grants and philanthropy play in your view of the school—can

you talk about [audio skip]?

AMY:
Projections and pro forma, we definitely take into account their track record for fundraising. But it is risky. It's not guaranteed in the same way that your public funding, your state or federal funding. You [audio skip] how much you have raised year over year, but if it is very volatile, goes up and down, it's something that we'll keep in mind, and I think what we'll really want to see is strong performance based on that public funding. And then how reliant you are on grants, funds, and philanthropies and your track record for hitting your targets every year.

TAMMIE:
Great. So we're moving now to the facilities. Are you looking at just the debt service coverage ratio, or are you also taking into account the cost of utilities, custodial work, etc., when you, I think someone knows that you said the [inaudible] cost being 12, 15 percent?

JOE:
Yes.

TAMMIE:
Should that include the other pieces too?

JOE:
Yes. I know a couple vendors look at this differently. So, I'm interested to hear what LIIF and Self-Help do, or a mortgage let's say. And we'll add in utilities. We don't really add in custodial, although I know some lenders do that. We don't really add that in. We try and make a comparison to what [audio skip] were paying one, sometimes 2 percent of their total operating budget on occupancy costs, and that's utilities and general upkeep. If the boiler goes you have to fix it, whereas charter schools were

spending between 12 and 15 percent. So any time you can drive the school below that 12 or 15 percent number, we think we've done well with [audio skip].

AMY:
We would, we do a very similar to the way you guys do it. The other thing that we might include are if there are building reserves…

JOE:
Right.

AMY:
…that need to be put in place, we'll take that into account or other source of things like that. But that would be the key thing, that like area. You know, if public funding rates, state rates are very low and real estate is very expensive, we'll see those at the higher end of the range. So the percentages we look at can be very dependent on where you're located.

REBECCA:
And I say we calculate. We would typically look at the whole package. That it would include custodial maintenance. But typically in our loans, we require a capital asset renewal account, which is [audio] we in comparison to sort of your total budget. We look at everything from custodial to rent to maintenance and repairs.

TAMMIE:
Can you talk about any experience you might have with the public-private educational facilities infrastructure [inaudible] in what question you might have for the panel, that would be great. Another question that came up was about more traditional banks. And [inaudible] you might have poorer schools that are applying for mortgages with

national banks or traditional banks, and I doubt you'll be able to do this, but if you have recommendations on specific banks.

REBECCA:
I would say for us that would be the smaller banks that are down the street who you maintain your checking accounts and your operating accounts with. That's a good source and often, I wouldn't say often, but it has happened that we get all the way to close to closing with the school and the relationship bank walks in [audio skip] it's a very good idea to look at recruiting representative from local banks onto your board. Not just for that relationship—that's a little cynical to do that—but because they bring that business acumen and that ability to work the five Cs perspective.

[Audio skip] and because I can't necessarily recommend this specifically, but I do know that Bank of America has a strong community development wing within the larger bank. So that may be kind of a hybrid there that would be a good relationship. Not necessarily Bank of America, but I think a lot of the large banks do.

AMY:
And I would reiterate what I said before that if you're looking at your local bank, you know, maybe [inaudible] and into charter school lending, which would be excellent, make sure you have a lot of lead time and make sure that you're going, they're going through their credit process early just in case they hit the very end and they're not able to do the loan for you that you have a Plan B in place.

But one of the roles that we all play is we really want to open up the capital markets for charter schools. So we work a lot of [audio skip] lend to charter schools or we also have come in as a subordinate lender in a way to get them more involved and engaged. So it's something that you don’t have to—I say that as an example in that you don’t always have to go to a bank or to a CDFI. There are situations where we’ll work together to try to [audio skip].

JOSH:
[Audio skip] the national banks play a major role in financing charter schools across the country. And I, maybe I shouldn’t be mentioning specific names but just to give you a sense, I mean, you know, Bank of America, PNC, BB&T, M&T, these are all banks that and many other national banks have financed charter schools and continue [audio skip] the participating in the webinar understand that there's also plenty of national banks who are very involved in charter school financing.

AMY:
And also call your other charter school partners, maybe if there’s a CMO in your region or other charter schools in your area that you know have access to local banks. I mean that’s a great way to find out who might be comfortable lending to charter schools.

JOSH:
The one, I just, the one—I'm sorry, but the one thing I would say that may be a little different working with some of these larger national banks as opposed to some of the CDFIs, and I think a everyone on the panel talked a little bit about the role of technology can but might be frustrated in your project changing so much over the course of its first inception to kind of at the point where you really have a financeable project. So there may be actually slightly different strategies in working with some local banks or CDFIs versus some of the larger national banks.

JOE:
In terms of tips and tricks working with the traditional banks, I would try to find out if you are being underwritten by the community development department, and if you can, get the loan on the community development department because they may be a little bit more flexible.

TAMMIE:
All should have [inaudible] start to think about doing a major project?

JOSH:
I'm not sure they're going to be totally responsive, but there are two roles that your savings play in getting through a facilities product. The first is that before you can get to the point of getting a loan for a project, you're going to have to spend some money up front in just getting to or doing your education specifications, but in order to evaluate various facility options that you might have. Savings play the role of allowing you to get to a place where you have a project and a financeable project. And then there's this skin in the game piece. And that really depends, and I'm sure our panelists will jump in here. But that really depends on [audio skip].

REBECCA:
It's not a magic number. I think you have the skin in the game. And once the skin goes into the building, it's not there to pay for an unexpected expense. So you need to have a balance among, so you have reserves that pay for some of the predevelopment expenses as Josh said. You have a certain amount that's going to go into the equity of your project and sort of your down payment, if you will. And you're also going to have a certain amount that needs to just always be cash on hand. I think the numbers need to be robust enough for you to weather storms and really have equity in your project.

I would say for us, in addition to the number, what we like to see and what the numbers represent to us is the discipline of saving. It's the willingness to forgo that XYZ flashy item or the extra program that would be really awesome to have but maybe it isn’t quite needed yet for our constituency in order to have the discipline of savings. And I think [inaudible] aren’t as big as you would like to see them, but if that school is saving every year, every month, every quarter, that says a lot about them as a borrower.

TAMMIE:
And I think our last question before we wrap up is about refinancing and a charter school that is not doing any new construction or new acquisition but [audio skip].

JOE:
[Audio skip] would say no just on the basis of it being a refinance. So just like the other scenarios, don't be afraid to have a conversation. Give us a call, send us an e-mail and we’ll reach out to you and talk to you about whether or not it's a product that we offer. Oftentimes if we don’t offer the product that you're looking for, we’re going to refer you to hopefully to someone who will offer you that product. So use our connections. It's not a [audio skip] my example at least, I may place you with one of these folks or somewhere else. But I don't think I'd say no to refinance outright just because it's a refinance.

JOSH:
Right. We’ve done a lot of refinancing work for charter schools—it's not atypical.

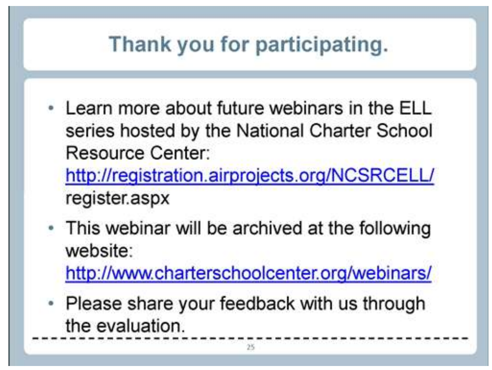
AMY:
I would say the only thing to consider in your

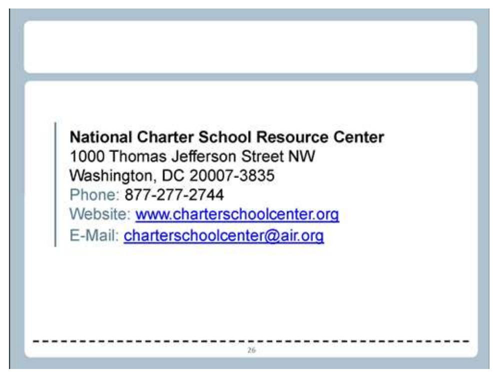
refinance is to make sure that the savings justifies the cost.

JOSH:
So, thank you so much. We're unfortunately out of time. But I want to take this opportunity to thank Rebecca and Amy and Joe for [audio skip] and next Wednesday for our fourth and final webinar in this series on predevelopment and construction management.

Slide 22

TAMMIE:
And if you could stay on for just a couple more minutes we have a brief survey we would like you to complete so we make sure that we are bringing [audio skip].





Slides 25 and 26