Financing Charter School Facilities

June 12, 2013
About the Resource Center

The U.S. Department of Education is committed to promoting effective practices, providing technical assistance, and disseminating the resources critical to ensuring the success of charter schools across the country. To that end, the Education Department, under a contract with American Institutes for Research, has developed the National Charter School Resource Center.
Charter School Financing
Webinar Presenters

Josh Kern
Principal
TenSquare

Amy Laughlin
Associate General Council
Low Income Investment Fund (LIIF)

Joe Palazzolo
Lending Team Leader
New Jersey Community Capital

Rebecca Rogers
Assistant General Council
Self-Help Credit Union / Self-Help Venture Fund
Today’s Learning Objectives

- Participants will understand the Five Cs of Lending and will be better prepared to apply for facilities financing.
- Participants will be able to analyze and use a *pro forma* budget and a debt service coverage ratio (DSCR) tool to prepare for construction financing.
- Participants will have the opportunity to engage with presenters and will leave this webinar better equipped to finance a facilities project.
Agenda

- Five Cs of Lending; or, how lenders look at you
  - Tool: Deep dive into a *pro forma* budget
- Different types of loans
  - Tool: Comparison of costs and benefits of each
- Applying for financing
  - Tool: Deep dive into a loan application, with a focus on common pitfalls
- Negotiating with lenders
  - Tool: Deep dive into a term sheet, with a focus on common mistakes and on what is and is not negotiable
The Five Cs of Lending

- Character
- Conditions
- Collateral
- Credit
- Capacity / cash flow
The Five Cs of Lending: Character

- Are roles and responsibilities clearly defined among authorizer, board of directors, and school management?
- Are documents and plans orderly? Are internal controls in place?
- Is there a committed, community-centric board in place, with well-defined roles and diverse skill sets? Is there a well-distributed balance of power on the board?
- Is there evidence of succession planning?
- Are there any conflicts of interest?
The Five Cs of Lending: Conditions / Competition

- How will the loan be used?
- What is the school’s operating history?
- What are the school’s enrollment and growth trends?
- How does the school’s student achievement compare to that of neighboring schools? Is the school’s performance improving?
- Who is the school’s authorizer? Is the school considered high performing by the authorizer?
- Is the term of the loan tied to charter length? Are there complicated political factors affecting the school?
The Five C’s of Lending: Collateral

- Is the property worth the amount of money that the school paid for it?
- What school assets can be used as collateral?
- Does the school have a down payment available?
- What is the loan-to-value ratio?
- Is the facility too expensive for the school to purchase or to operate? Occupancy costs should not exceed 15 percent to 20 percent of gross revenue.
- Has the lender requested an appraisal and Environmental Phase I assessment?
The Five Cs of Lending: Credit

- What is the present financial condition of the school? How has the school performed financially in the past?
- What is the school’s credit history? Are bills paid on time?
  - Lender’s review: credit reports, tax returns, audited financial statements, year-to-date financial statements, projections
- Balance sheet: How much cash does the school have on hand? Does the school have three months of operating capital? How much debt? Is the ratio of liquid assets to current liabilities greater than 0.4? Is the ratio of total debt to net assets less than 3.5?
- Income statement: Does the school have positive net income?
The Five Cs of Lending: Capacity / Cash flow

• Will the school be able to repay a loan without negatively impacting program quality?

Debt Service Coverage Ratio (DSCR):

\[
\frac{\text{Net income} + \text{interest} + \text{depreciation} + \text{amortization} + \text{rent}}{\text{Interest expense} + \text{current portion of long-term debt}}
\]
The Five Cs of Lending: Tool—*Pro Forma* Budget
Different Types of Loans

- Construction loans
  - Interest-only, 6–18 month terms, capitalized interest

- Leasehold improvement loans
  - Term matches lease, leasehold mortgage / lease assignment as collateral

- Permanent loans
  - Longer term (7–10 years), maximum loan-to-value, fully amortizing or with balloon payment

- New markets tax credits, tax exempt bonds
  - Better for larger deal sizes, more complex structures
  - NMTCs: Interest-only, refinance at seven years
  - Bonds: amortizing, provide longer term debt
## Comparison: Financing Options

<table>
<thead>
<tr>
<th></th>
<th>Traditional Mortgages</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>
<td>Typically $5 million + based on cost of issuance</td>
</tr>
<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>
</tr>
<tr>
<td><strong>Benefits</strong></td>
<td>Appropriate for smaller, less complex transactions</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>
</tbody>
</table>
## Cost of Debt

<table>
<thead>
<tr>
<th>Lending Institutions</th>
<th>Traditional Banks</th>
<th>Community Development Lenders</th>
<th>Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan terms</td>
<td>10–15 years</td>
<td>Up to 10 years</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 closing costs, attorney fees)</td>
<td>1%–3%</td>
<td>1%–2%</td>
<td>5%–10%</td>
</tr>
<tr>
<td>Interest rates</td>
<td>5%–8%</td>
<td>5%–8%</td>
<td>3%–6%</td>
</tr>
</tbody>
</table>
Applying for a Loan: How to Prepare

- Preapplication—three months to three years
  - Build equity for investment (minimum 10 percent)
  - Acquire construction project capacity by retaining qualified and bonded professionals
- Key documents to prepare:
  - Academic performance data
  - Enrollment data
  - Three years of financial statements
  - Current year financial statements
  - Project budget
REQUIRED ATTACHMENTS

The items listed below are the preliminary information required in order for New Jersey Community Capital to begin its due diligence investigation for the requested loan. Please note that due diligence investigation will only commence after each of the items below has been received by the Applicant and/or Charter School. Submission of the materials and reports below does not prevent New Jersey Community Capital from requiring an updated version of the submitted material (i.e. an updated appraisal or updated operating projections).

- Completed United States Department of Education Charter Schools Facilities grant application together with all supporting documentation as set forth in the application (this document)

- Charter School Organizational Materials
  - Brief overview and history of the Charter School (annual reports, newsletters, etc.)
  - Articles of Incorporation, Bylaws, 501(c)(3) tax determination letter (if applicable)
  - Board of Directors and their Professional Affiliations
  - Organizational Chart and Resumes of Key Staff Members
  - Educational or Charter Management Organization contract (if applicable)

- Charter School Financial Information
  - Audited financial statements for the last three fiscal year ends
  - Management prepared financial statements for the most current period
  - Authorizer approved Charter School budget for the current fiscal year
    - NJDOE approved 108-line budget
    - Month-by-month projections for the current fiscal year
Applying For a Loan: Tool—Loan Application Page 2

- Charter School Enrollment Information
  - Current and projected enrollment by grade
  - Current waiting list by grade
  - List of sending districts and the number of students enrolled from each sending district
  - Profile of the current student body
    - Demographic information
    - Total number of students classified by the Office of Special Education Programs
    - Total number of students classified as Limited English Proficiency (LEP)
    - Total number of students eligible for free lunch
    - Total number of students eligible for reduced-price lunch
  - Analysis of student performance on standardized tests versus primary sending district

- Applicant Information (if different than Charter School)
  - Description of organization and organizational structure
  - Board of Directors and their Professional Affiliations
  - Financial information (last three fiscal year ends, current period, budget)
  - All agreements between the Applicant and the Charter School

- Project Information
  - Total dollar amount of requested loan
  - Description of proposed project
  - Development budget, including proposed sources and uses of funds
  - 10-Year operating projections showing impact of the project on the school’s budget
  - Contracts (lease, contract of sale, etc.)
  - Reports (architectural, appraisal, environmental, etc.)
Negotiating Terms and Conditions

Term sheet versus commitment letter

• Letter of interest / term sheet
  ▪ Preliminary and negotiable
  ▪ Prior to full underwriting and credit approval

• Commitment letter
  ▪ Agreed-upon terms, after credit approval
  ▪ Basis for the legal documents
Negotiating Terms and Conditions

Typical terms

- **Loan amount**
  - Loan-to-value (LTV)
  - Equity requirements: paid upfront
- **Pricing**
  - Interest rate: fixed or variable
  - Fees: origination fees, legal costs
  - Interest only versus amortization schedule: balloon payments
- **Term of loan**
- **Collateral**
  - Real estate, debt service reserves, UCC filing
Negotiating Terms and Conditions

- Ongoing financial covenants
  - Debt service coverage ratio
  - Leverage requirements (debt-to-worth ratio)
  - Liquidity requirements (current ratio, days cash on hand)

- Reporting requirements
  - Audits, interim financials, enrollment / ADA, academic reports

- Closing conditions
  - Appraisals, environmental assessment, plan / cost reviews
  - Construction readiness (contracts, permits)
  - Final legal documents
  - Closing deadlines
Presenters

Josh Kern
Principal
TenSquare
Josh@thetensquaregroup.com

Amy Laughlin
Associate General Counsel
Low Income Investment Fund (LIIF)
ALaughlin@liifund.org

Joe Palazzolo
Lending Team Leader
New Jersey Community Capital
Jpalazzolo@njclif.com

Rebecca Rogers
Assistant General Counsel
Self-Help Credit Union / Self-Help Venture Fund
Rebecca.rogers@self-help.org
Discussion
Questions?

Raise your hand or enter your question in the chat box on the left side of your screen.
Thank you for participating.

• Learn more about future webinars in the ELL series hosted by the National Charter School Resource Center: http://registration.airprojects.org/NCSRCELL/register.aspx

• This webinar will be archived at the following website: http://www.charterschoolcenter.org/webinars/

• Please share your feedback with us through the evaluation.
National Charter School Resource Center
1000 Thomas Jefferson Street NW
Washington, DC 20007-3835
Phone: 877-277-2744
Website: www.charterschoolcenter.org
E-Mail: charterschoolcenter@air.org