

National **Charter School**
Resource Center

at American Institutes for Research

Financing Charter School Facilities

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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

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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):

Net income + interest + depreciation + amortization + rent

Interest expense + 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

	Traditional Mortgages	New Markets Tax Credits	Tax Exempt Bonds
Loan Amount	Loan amounts vary	Typically \$5 million + based on cost of issuance	Typically \$5 million + based on cost of issuance
Loan Structure	Terms and amortization vary	Generally 7 years, interest only	Up to 30 years, amortizing
Loan-to-Value	Up to 90%	Up to 90%	100%
Benefits	Appropriate for smaller, less complex transactions	Interest only period; 20%–25% “debt forgiveness”; attractive interest rates	Long-term financing; attractive interest rates
Challenges	May have to refinance	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	Only the strongest school applicants are eligible, can be difficult for new schools; complex transactions with higher legal costs; locked into longer terms

Cost of Debt

Lending Institutions	Traditional Banks	Community Development Lenders	Bonds
Loan terms	10–15 years	Up to 10 years	Up to 30 years
Loan-to-value	70%–80%	80%–90% (sometimes higher)	Up to 100% (sometimes higher)
Fees (include closing costs, attorney fees)	1%–3%	1%–2%	5%–10%
Interest rates	5%–8%	5%–8%	3%–6%

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

Applying For a Loan: Tool—Loan Application

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

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- 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 bdg et
 - 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

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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.

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