

National Alliance for Public Charter Schools Conference

Facilities Financing Overview & Best Practices: Tax Exempt Bonds

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Agenda:

- **Overview of bond financing**
- **Rating Agency perspective**
- **Underwriter perspective**
- **Case study of an experienced school**
- **Questions & Answers**



Overview of traditional tax-exempt financing for charters

What can be financed with tax-exempt bonds?

Capital Expenditure Projects

- Acquisition or construction of a facility or project
- Land, buildings, equipment and/or related infrastructure
- Funds may be used to reimburse the charter school for amounts already expended

Refinancing Prior Debt

- Refinance outstanding taxable debt acquired in connection with capital projects
- Construction financing, New Markets Tax Credit financings, bank loans and mortgages

Requirements of traditional tax-exempt bonds

1. Qualified 501(c)(3) status or governmental status

- Ownership of the project by 501(c)(3) organization or public instrumentality
- Use of the project by 501(c)(3) organization or public instrumentality

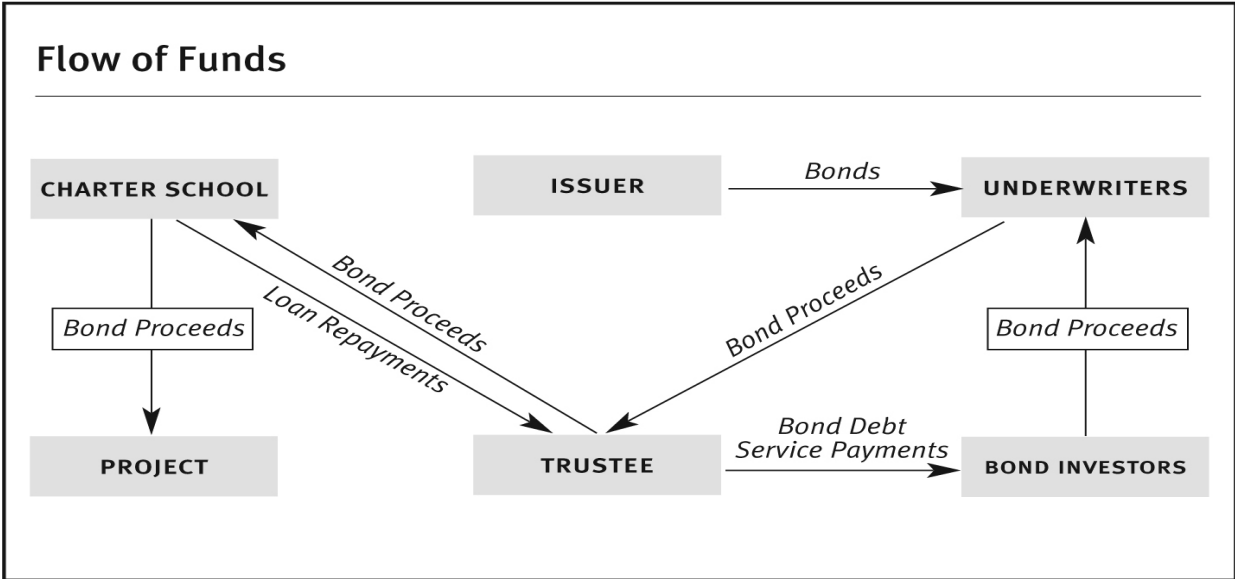
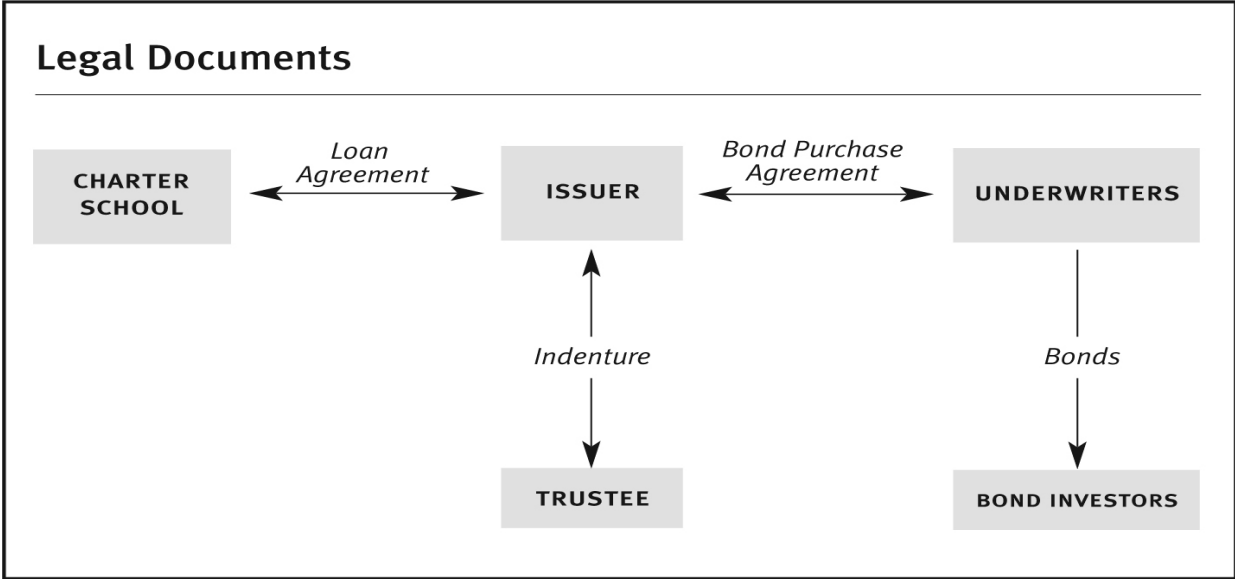
2. No Private Use*

- Any private entity that is not 501(c)(3) or governmental [5% limit]

3. No Private Loan

- Any private entity that is not 501(c)(3) or governmental

How does it work?



Parties involved in the financing team

Underwriter

- Structures the bonds for successful marketing to the investor community to ensure the lowest interest rate possible for the charter school
- Serves as original purchaser of all the bonds for reoffering to investors
- Underwriter selection is critical to success of the transaction

Issuer

- Governmental entity issuing the bonds and making the loan to the charter school
- Coordinates public hearings required under local law and tax law
- Examples include: (1) a local industrial development authority or joint power financing authority, (2) a local government entity (city, county or school district), (3) special conduit instrumentality of the state government (e.g., California School Finance Authority), (4) special issuer with national financing power such as Public Finance Authority (Wisconsin), IDA of Pima County (Arizona)
- Important legal and practical analysis required before selecting an issuer

Financing team? (cont)

Borrower's Counsel – represents the charter school in the transaction

- Responsible for reviewing and negotiating provisions of all documents to which the charter school is a party
- Will provide an opinion regarding the tax-exempt status of the charter school, the validity of the actions it has taken to approve the financing, and its good standing under state law, among other matters
- Expertise in local charter school law, real estate law, federal tax law and federal securities law required

Bond and Disclosure Counsel – represents the Issuer, however, typically chosen by the charter school

- Responsible for approving the legal structure, drafting the legal documents and conducting tax due diligence (as bond counsel)
- Responsible for drafting the public market disclosure document and conducting finance and operations due diligence (as disclosure counsel)
- Will provide an opinion on the validity and tax exemption of the Bonds

Financing team? (cont)

Financial Advisor

- Under new SEC rules, advisor has a fiduciary duty to the charter school
 - Duty of Loyalty: to act in its client's best interests without regard to its own interests
 - Duty of Care: must be qualified to undertake engagement; consider financing alternatives

Trustee

- A national trustee bank that collects, maintains and disburses the moneys in connection with the bonds
- Enforces the rights of the bondholders if a default occurs

Rating Agency

- Rating agency is a third party evaluator of the transaction once it is “fully baked”; not part of the team in terms of structuring and credit decisions
- Standard & Poor's is the only major rating agency that is actively focused on the charter school bond sector



Rating Agency perspective on the Charter School Sector



NAPCS Presentation

Carlotta Mills
Director
U.S. Public Finance

June 30, 2014

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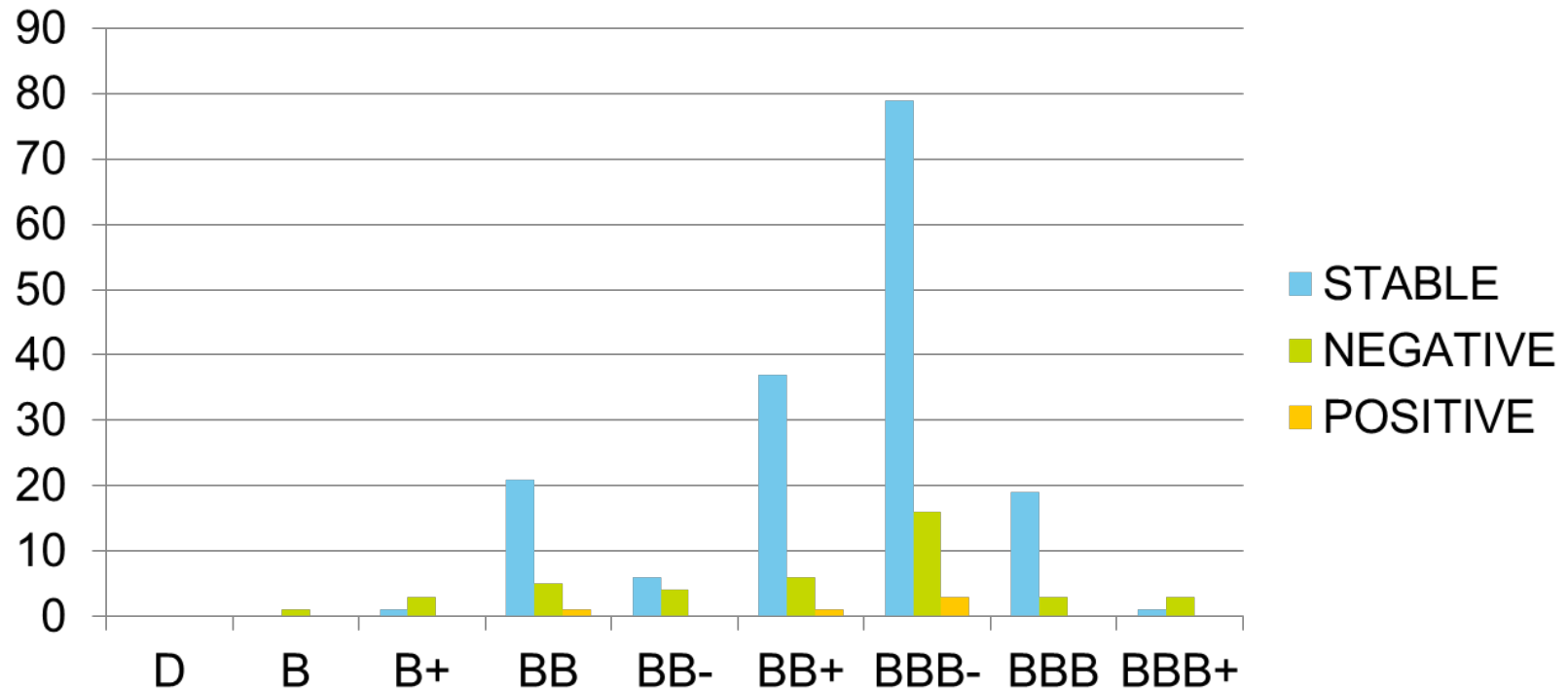
The **ABC**'s of Rating Charter School Debt

S&P Ratings Services and Charter School Debt

- **A growing universe**
 - S&P has been rating charter schools since the late 1990's
 - 214 charter schools are currently rated by S&P
- **Broad geographic distribution**
 - S&P rates charter schools in 24 states
- **Criteria informs ratings**
 - Provides the framework by which we rate charter schools

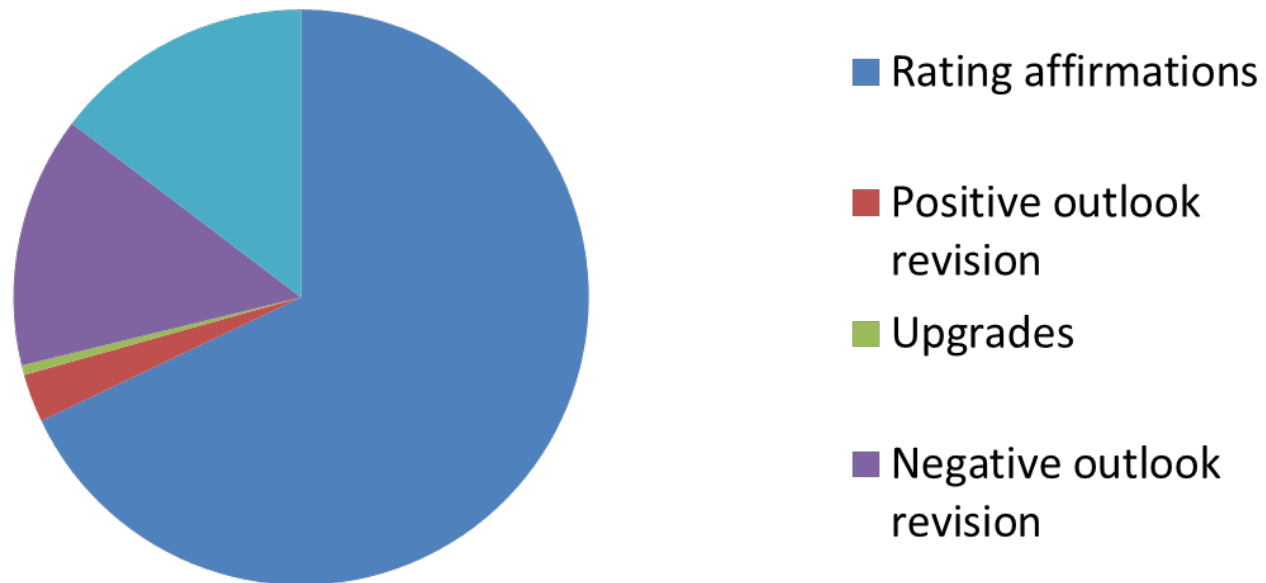
A Growing Universe

Most public unenhanced ratings fall into the investment grade category



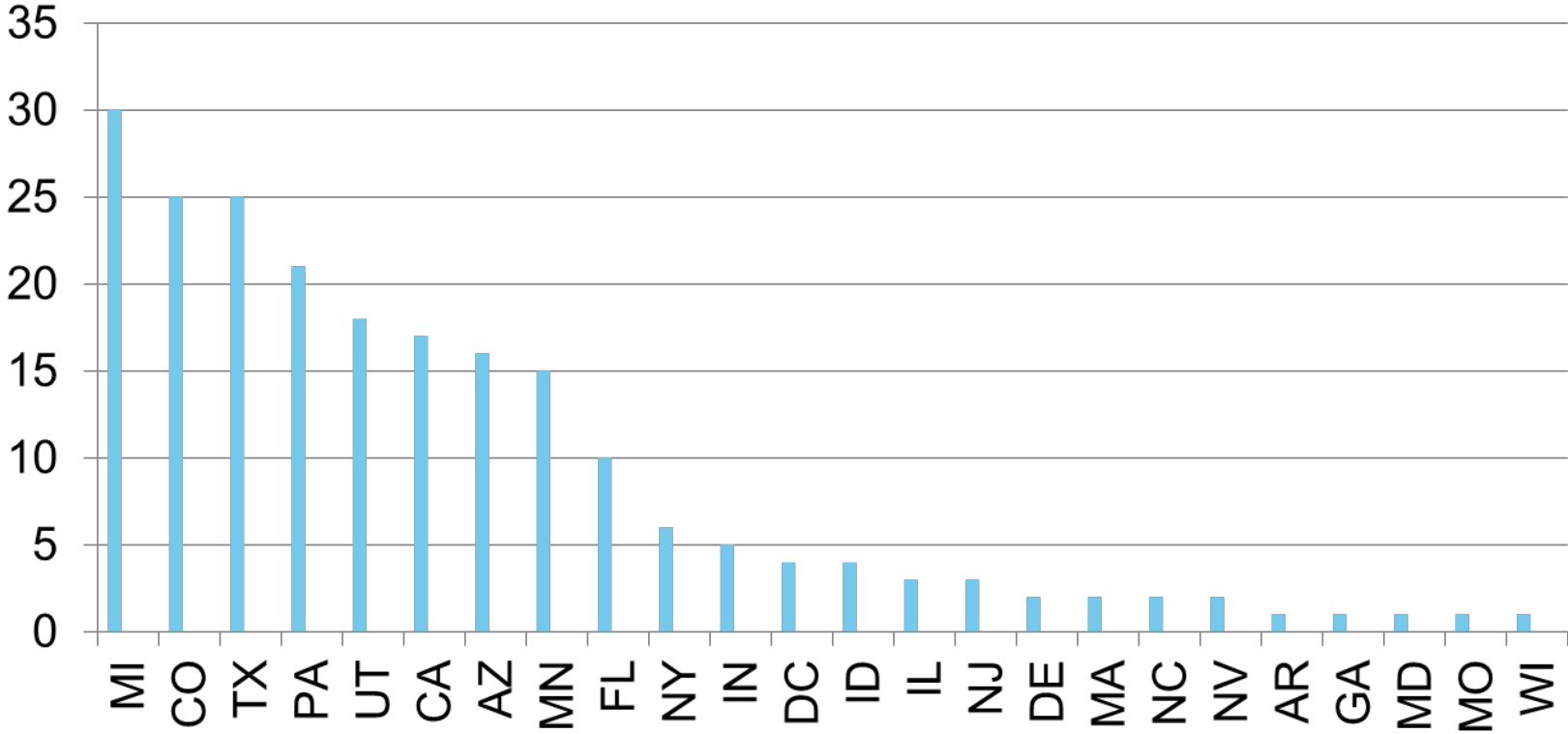
A Growing Universe (continued)

60% of all rating actions are affirmations, 25% are downgrades or negative rating outlooks, 3% are upgrades or positive rating outlooks



Broad Geographic Distribution

S&P rates schools in 24 states



Criteria Informs Ratings

Enterprise Profile

- **Charter framework:**
 - Number of renewals, expiration, enrollment caps, relationship with authorizer
- **Management and governance:**
 - Board, founders, consultants, policies, tenure
- **Demographics:**
 - Competition, geography, transportation
- **Demand:**
 - Enrollment/waitlist trends, enrollment/facility caps, growth plans

Criteria Informs Ratings (continued)

Financial Profile

- **Operations:**
 - State funding, margins, coverage, carrying charge, budgeting
- **Balance Sheet:**
 - Cash/liquidity, debt, capital planning, and expansion risk
- **Debt:**
 - security, covenants, pledge

Macro Trends

- **Growing** sector in terms of schools, debt and ratings
- Many states are going through a **second wave** of legislation
- Changes in oversight and **authorizers**
- **Moral obligation** programs
- Changes in measuring **performance**

Macro Trends (continued)

- Better reporting and **transparency**
- Slowly improving **state funding** environments
- Recent smaller **operating** margins
- Increased **liquidity** constraints
- Debt **covenants** are more restrictive or some institutions with current debt are not meeting covenants and there are technical defaults to understand

Outlook: Negative

- The lingering effect of several years of funding decreases in certain states
- Enrollment declines, sometimes with increased competition
- Academic concerns as state and national performance frameworks continue to evolve
- Threats of charter revocation or limited renewal by authorizers; and
- Lack of management oversight



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**Underwriter perspective on charter
school bonds and transaction process**

Charter School Bond Guidelines: *Global / State Credit Considerations*

- Underwriters and investors consider the legal and regulatory environment in which a charter school financing candidate operates, including:

State Charter Law

- Regulatory Oversight (or lack thereof)
- Authorization and Renewal Process

Political Climate

- Elected Officials
- School Districts
- Teacher's Union

Local Funding Sources

- Funding Determination and Amount (i.e., legislative process, annual escalators, etc.)
- Equity (or lack thereof) as Compared to District Schools
- Capital Assistance

Charter School Bond Guidelines: *School Specific Credit Considerations*

Underwriters and investors also consider a number of general factors related to the specific operations and project of a charter school financing candidate, including:

Student Information

- **Student Counts:** Historical and projected, by grade levels served. Generally, bond eligible schools have 300+ existing students.
- **Student Demand:** Demand for the educational product, proven through student applications & waiting lists, exhibited competitive advantages.
- **Educational Performance:** Test scores (relative to competing schools), compliance with performance benchmarks, exhibited educational outcomes.

Financial Information

- **Operating History & Audits:** Schools or CMOs need to have at least 3 years of operating history and two years of audited financial statements.
- **Financial Results:** Positive/improving (net revenues, liquidity, etc.).
- **Reasonable Leverage:** Generally limit debt payments for facilities to 20% of unrestricted revenues.

Organizational Information

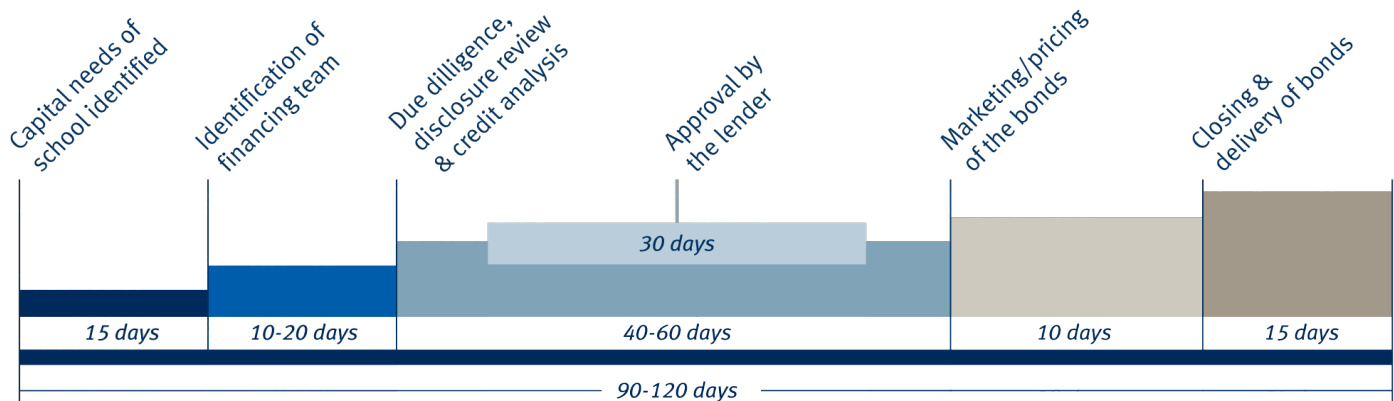
- **Administration & Staff:** Experienced and qualified, both in terms of education, administration & finance.
- **Governance:** Preference for boards comprised of non-related parties with diverse backgrounds in areas such as finance, law, real estate & fundraising.
- **Legal Structure:** Governmental or not-for-profit corporation with federal tax-exempt designation.
- **Charter:** In compliance and in good standing with qualified authorizer. Generally, schools with long-term charters or with a historical record of renewal are viewed more positively by bond investors.

Project Information

- **Identified and Well Defined Project:** Targeted real estate must be under contract at the outset and clearly meet the needs/plans of the school.
- **Real Estate Matters:** Necessary environmental, zoning/permitting completed and in place prior to release of any bond proceeds.
- **Costs:** Construction and renovation projects require guaranteed maximum price (GMP) contract and reasonable completion bonds.

Charter School Bond Process: Typical Process & Timetable

Pre-Bond Processing	Bond Issue Processing	Bond Sale & Closing
<ul style="list-style-type: none"> ▪ School identifies project <ul style="list-style-type: none"> ✓ Scope & purpose ✓ Feasibility – Demand & economic viability ▪ School identifies key financing team parties <ul style="list-style-type: none"> ✓ Investment Banker (RBCCM) ✓ Legal Counsel ✓ Issuer 	<ul style="list-style-type: none"> ▪ RBCCM, as investment banker, collects/ reviews credit due diligence materials; initial sizing and structuring of bond issue ▪ Legal counsel prepares form of legal documents and offering prospectus ▪ Issuance approvals processed ▪ Rating agency review, if merited 	<ul style="list-style-type: none"> ▪ Offering prospectus distributed to potential investors ▪ Once sufficient demand is determined, interest rates are set and formal orders from investors are taken (bond purchase agreement executed) ▪ Legal team and RBCCM process finalize documentation and transfer of funds for closing



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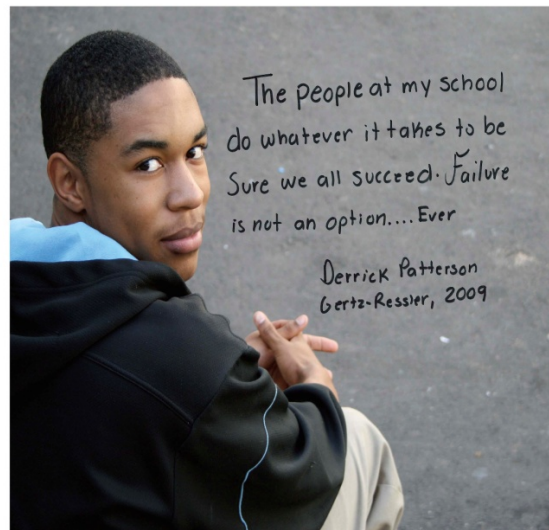


**Charter school borrower – a case study of
an experienced user of bonds**



Los Angeles, California





Mission Statement

The Alliance mission is to open and operate a network of small high-performing 9-12 and 6-8 public schools in historically underachieving, low income, communities in California that will annually demonstrate significantly higher student academic achievement growth and graduate students ready for success in college.



Five Core Values



1. High Expectations for All Students
2. Small, Safe Personalized Schools and Classrooms
3. Increased Instructional Time
4. Highly Effective Principals and Teachers Accountable for Results
5. Parents as Partners



Students and Families We Serve

- 26 schools including 9 middle schools
- 10,770 students, 90% Latino, 8% African American
- 93% Free/Reduced Meals
- 6% to 11% Special Ed Students across schools
- 17% English Language Learners

"When I received my college acceptance letter I thought... stuff like this doesn't happen to kids like me. My hard work, and the encouragement and support of my teachers, paid off. Now all my dreams are coming true."

*Angelica Gutierrez, Gertz-Ressler 2009
Vassar College 2013*





Proven Track Record of Results

"We believe all students can achieve at high levels, we give them the opportunity."





Academic Performance Index (API)

- ★ 3 Alliance high schools among top 10 highest performing in LAUSD
- ★ 55% of Alliance high schools above CA average

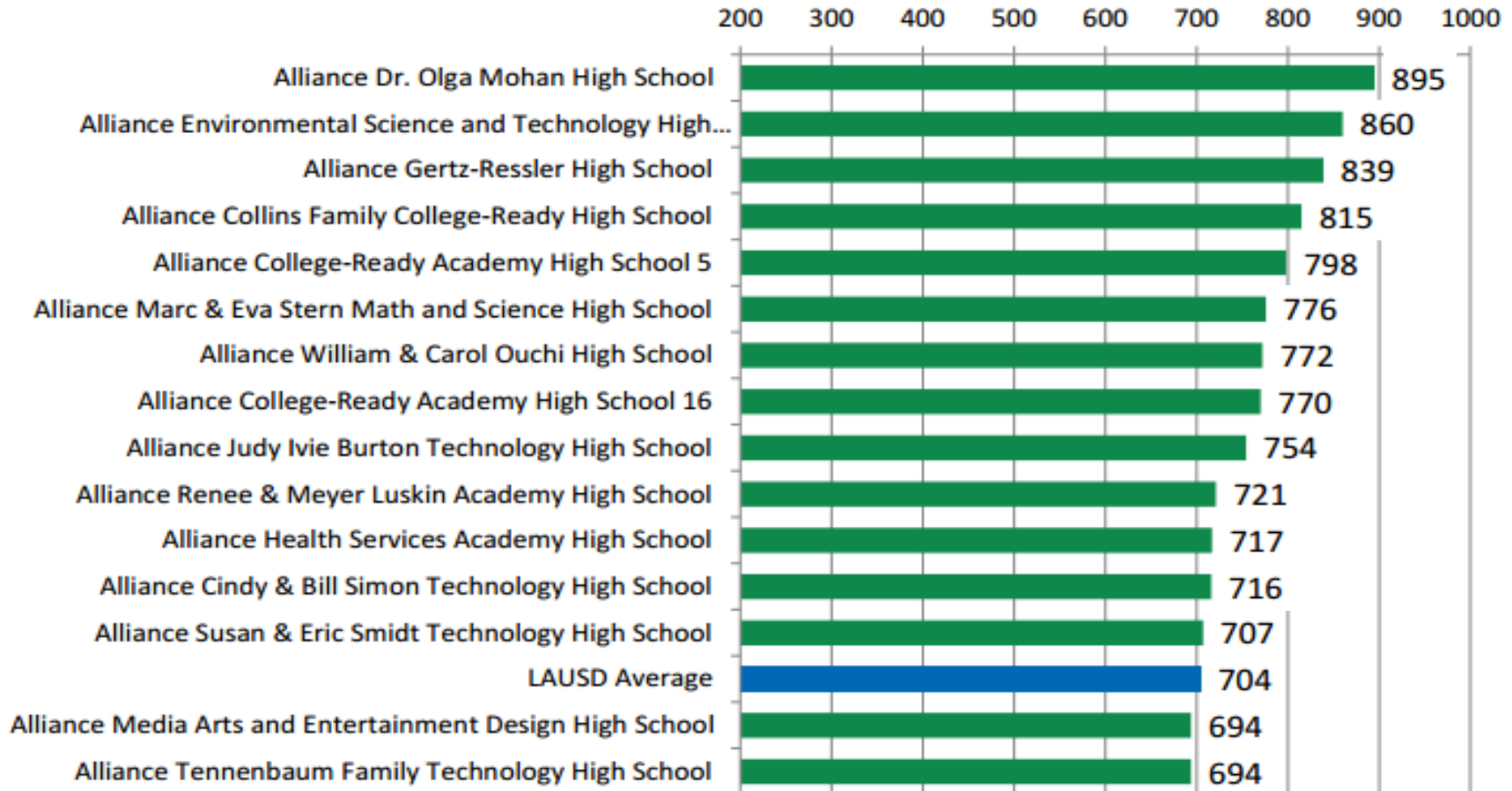
Academic Milestones Achieved

- ★ Increased % of Alliance-wide students advanced/proficient in math from 9% to 37%
- ★ 99% 4-year graduation rate
- ★ 86% of high school graduates accepted in 4-year colleges
- ★ 97% Average Daily Attendance Rate
- ★ 17% ELL Reclassification Rate
- ★ 4 CA Distinguished High Schools





2013 Academic Performance Index (API) Alliance Among High Schools in Los Angeles Unified School District



ACRPS ORGANIZATION

Alliance Facilities

High Schools 501(c) 3 Corporations

1. Gertz Ressler (2004)
2. Judy Ivie Burton Technology Academy (2005)
3. Collins Family (2005)
4. Dr. Olga Mohan (2006)
5. Marc and Eva Stern MASS (2006)
6. William and Carol Ouchi (2006)
7. College Ready Academy No. 5 (2007)
8. Luskin (2007)
9. Environmental Science and Technology (2009)
10. Health Science Academy (2009)
11. Media Arts Academy and Entertainment (2009)
12. College Ready Academy No. 11 (2010)
13. Bloomfield (2014)
14. College Ready Academy No. 20 (2014)
15. College Ready Academy No. 16 (2011)
16. Cindy and Bill Simon Technology (2010)
17. Susan and Eric Smidt Technology (2012)

Alliance Corporate (CMO)

Middle Schools 501(c) 3 Corporations

1. Richard Merkin (2005)
2. Jack H. Skirball (2007)
3. Christine O'Donovan Middle Academy (2008)
4. College Ready Middle Academy No. 4 (2009)
5. College Ready Middle Academy No. 5 (2009)
6. College Ready Middle Academy No. 7 (2010)
7. College Ready Middle Academy No. 8 (2014)
8. College Ready Middle Academy No. 9 (2014)
9. College Ready Middle Academy No.12 (2013)

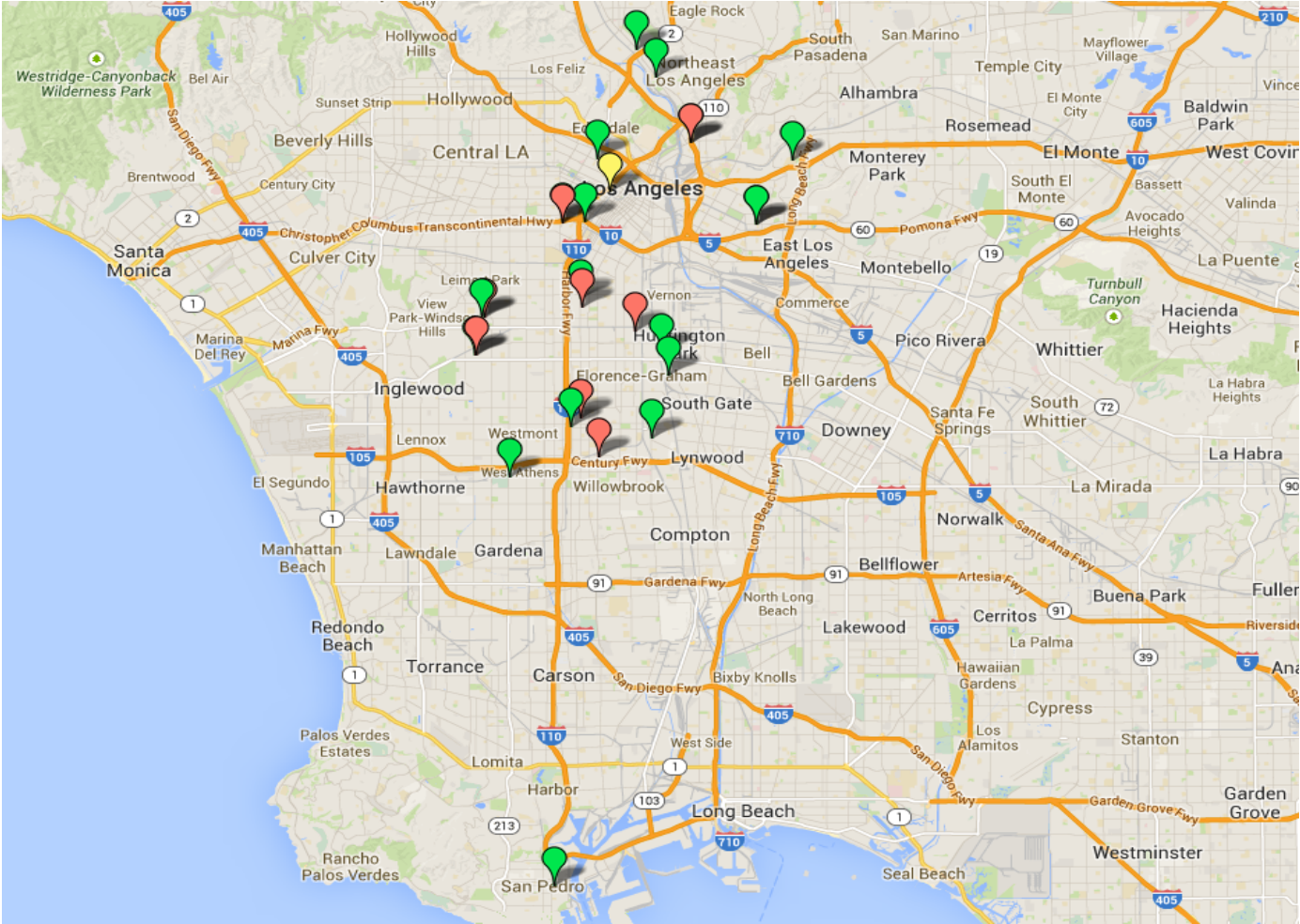
Non-Profit Single Purpose Entities

- 2023 Union LLC
- Alliance Real Estate Holdings LLC
- HP 2071 Saturn LLC
- 5151 Titan LLC
- 54th Street LLC
- 11410 Avalon LLC
- 9719 Main Street Charter Facility LLC
- 10101 Broadway Charter Facility LLC
- 10704 Wilmington LLC
- 7907 Santa Fe LLC
- 1552 Rockwood LLC
- 461 W. 9th Street LLC
- 5886 Compton LLC
- 1918 Broadway Facility LLC
- 1918 Broadway Financing LLC
- 113 S. Rowan
- 6900 8th Ave C.F. LLC
- 70th Street C.F. LLC
- 4610 Main Street LLC
- 49th & Main LLC
- 3640 E. 1st St. LLC

- All Single Member LLC



Alliance Communities





Facilities Finance



-22 Schools are in permanent facilities

- Approximately \$77M – NMTC
- Approximately \$63M – Bond

Note: Average Borrowing cost of 5.4% and with \$57M subject to 20% discounts (16M) due to new market tax credits.

Facilities Borrowings Entity	School	Date Closed	Maturity	Outstanding as of 03/31/2014	Interest Rate
2023 Union LLC	Gertz/Merkin	10/24/2013	10/24/2014	\$16,881,095	6.23%
11410 Avalon LLC	Skirball	08/01/2011	11/19/2015	\$5,848,696	6.23%
5151 Titan LLC	MASS	02/17/2009	02/17/2016	\$8,055,480	4.65%
54 th Street LLC	Ouchi/O'Donovan	08/01/2011	07/01/2016	\$14,232,989	5.87%
HP 2071 Saturn LLC	Collins	05/23/2007	07/01/2042	\$15,730,000	5.32%
10704 Wilmington LLC	Simon	11/18/2011	07/20/2018	\$8,041,387	5.15%
10101 Broadway LLC	Burton	12/28/2010	07/20/2018	\$5,774,817	5.18%
9719 Main LLC	CRMA#4	12/28/2010	7/20/2018	\$5,322,685	5.22%





Facilities Finance Con't



Facilities Borrowings				Outstanding as of	
Entity	School	Date Close	Maturity	03/31/2014	Interest Rate
6900 8 th Ave LLC	MS#7	08/26/2011	06/17/2031	\$9,463,822	6.22%
70 th Street LLC	Luskin	08/26/2011	12/01/1951	\$10,587,459	5.79%
1918 Broadway Facilities LLC	Smidt/MS#5	11/09/2011	12/01/1951	\$21,208,411	5.15%
1918 Broadway Financing LLC	Smidt/MS#5	11/09/2011	09/15/2030	\$15,012,675	7.46%
7907 Santa Fe LLC	Bloomfield	08/20/2013	08/20/2028	\$10,750,000	6.5%
5886 Compton Ave LLC	MS#9	12/13/2013	06/18/2015	\$7,580,000	3.75%
49 th & Main LLC	MS#12	01/17/2014	12/31/2015	\$2,500,000	2.16%
4610 Main Street LLC	HS#5	02/13/2012	07/01/2048	\$8,455,000	6.25%
113 S. Rowan LLC	MS#8/MediaArts	12/05/2013	12/05/2020	\$8,762,268	3.794%
1152 Rockwood LLC	HS#16	01/28/2014	01/31/2017	\$8,045,000	3.48% – LIBOR + 3.25%
461 W. 9 th Street	HS#20	05/23/2014	03/15/2031	\$8,975,000	5.7375%
Total				276,226,784	5.2%



Facilities Finance Con't

- Schools looking for permanent facilities
 - Environmental Science HS
 - Health Services HS - Prop 1D (\$64M)
 - ½ Grant
 - ½ Low interest loan
 - CRMA 10 (new)
 - HS 21 (new)

Maximum Allowable Debt Service Per Student: \$1,100





Facilities Finance Con't



Financing Technique	Project	Financing Technique	Project
Tax Exempt Bonds	HP Saturn 54 th Street/11410 Avalon 4610 Main 2023 Union	NMTC + QSCB	1918 Broadway
New Markets Tax Credits (NMTC)	5151 Titan 10704 Wilmington 10101 Broadway 9719 Main 70 th Street 6900 8 th Avenue 113 S. Rowan	Qualified Zone Academy Bonds (QZAB)	461 W. 9 th
Qualified School Construction Bonds (QSCB)	7907 Santa Fe	Bank Construction Loans	5886 Compton 49 th & Main 1552 Rockwood
		Obligated Group	TBD





Growth Strategy

Smart Growth

- 2 schools per year (1 MS, 1 HS on 1 site)
- Only in permanent sites
- Only if long term leasing, capital, or financing are affordable and in place



Presenter contact information

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Speaker Bio

William Wildman, Director,
Royal Bank of Canada Capital Markets (RBCCM)

Mr. Wildman has over 30 years experience in municipal finance having served as senior manager on over \$12 billion in transactions. His areas of concentration include charter schools, affordable housing, and infrastructure finance. Since completing the nation's first investment-grade charter school transaction in 2000, the RBCCM charter school group has senior managed over \$1,300,000,000 in charter school transactions in 14 states. In 2010 two deals that Bill managed won regional Bond Buyer Deal of the Year Awards, the first time charter schools were so honored. The \$67,000,000 KIPP Houston deal was voted Southwest Deal of the Year and the \$12,000,000 High Tech High was voted Far West Deal of the Year. In 2011, Bill managed a \$22,000,000 transaction for the Alliance for College-Ready Public Schools that enabled the Alliance to pre-pay two New Market Tax Credit CDE loans and deploy the proceeds to two new construction projects.

Speaker Bio

EUGENE CLARK-HERRERA, a partner in Orrick's Public Finance Group, focuses his practice on financing for school and college facilities, as well as city and county facilities and infrastructure. His practice includes serving as bond and disclosure counsel on revenue and tax-supported bond financing involving charter schools, counties, cities, school and college districts, airports, and student and multi-family housing projects. Mr. Clark-Herrera has experience with a variety of financing structures and characteristics, including pension obligation bonds, synthetic fixed rate bonds, and various reinvestment vehicles.

Mr. Clark-Herrera is Chair of Orrick's Charter School Finance Group, and has served as bond counsel for public charter schools across the country in debt financing transactions for over ten years. He pioneered capital markets access for California public charter schools, structured the largest multi-campus single-issuer public charter school financing to date, and has advised governmental issuers, foundations, advocacy groups and policy makers in the development and expansion of public charter school access to tax-advantaged financing.

Representative charter school transactions include:

- **Aspire Public Schools** (multi-campus) – \$93MM California Statewide Communities Development Authority, Revenue Bonds, Series 2010
- **Bronx Charter School for Excellence** – \$24MM Build New York City Resource Corporation, Revenue Bonds, Series 2013
- **Concept Schools** (Ohio/Illinois) - \$33MM Industrial Development Authority of the County of Pima Educational Facility Revenue Bonds (New Plan Learning, Inc, Project), Series 2011
- **Alliance for College Ready Public Schools** (47th Street Project) – \$8.4MM California Statewide Communities Development Authority, Revenue Bonds, Series 2010
- **High Tech High** (North County K-8 Project) – \$3.5MM California School Finance Authority, Revenue Bonds, Series 2011 (Qualified School Construction Bonds)
- **Rocketship School #4** (San Jose) – \$10.1MM California Statewide Communities Development Authority, Revenue Bonds, Series 2010

Mr. Clark-Herrera also serves on the Board of Directors of the nonprofit Mural Music & Arts Project, an arts-based youth development organization he founded in the San Francisco Bay Area to educate, inspire and empower teens through the arts.

Mr. Clark-Herrera earned a J.D. at Stanford Law School, and a B.S. in Business Administration at University of Colorado, Boulder. Prior to joining Orrick, Mr. Clark-Herrera was a public school teacher and science curriculum developer in the South Bronx and Washington Heights neighborhoods of New York City from 1993 to 1998. He is an alumni of the Teach for America Corps.