Board Agenda Item #	Item #III E
Date:	December 8, 2016
To:	MPS Board
From:	Caprice Young, Ed.D., CEO & Superintendent, Frank Gonzalez, Chief Growth Officer
Staff Lead:	Steven Kao, Senior Financial Analyst
RE:	Facilities Update

Proposed Board Recommendation

This memo will provide an update of the capital budget and discuss strategies of financing the projects involved.

Board approval is requested for intra-company loans that could be needed to fund short-term financing needs related to MSA-SA's Café-Gym-Auditorium and MSA-SD's portable classroom expansion.

Background

Updated Capital Budget – Magnolia's capital projects are described below. Note that MSA-7 is no longer included since the landlord notified us that they will be implementing their own capital improvement plan.

- **MSA-1:** Development and construction of a new educational building in Reseda, CA.
- **MSA-SA:** Construction of a DSA approved gymnasium.
- **MSA-SD:** Development and construction of portable classrooms on a new school site on a parcel of land owned by the school district.

Estimated costs and additional enrollment created by the capital projects are included below:

	MSA-SD	MSA-SA	MSA-1	Total
Soft Costs	359,508	310,000	474,200	1,143,708
Hard Costs	1,150,000	3,000,000	4,964,484	9,114,484
Soft & Hard Costs	**1,509,508**	**3,310,000**	**5,438,684**	**10,258,192**
Acquisition Costs	1,800,000	0	2,828,000	4,628,000
Total Costs	**3,309,508**	**3,310,000**	**8,266,684**	**14,886,192**

The projects are expected to increase enrollment:

	MSA-1	MSA-SA	MSA-SD	Total
Current Enrollment	543	630	426	1,899
Additional Enrollment	382	390	24	946
New Total Enrollment	**925**	**1,020**	**450**	**2,845**

The timing of expenditures related to the capital growth projects are to span through the next 12 months, however projects are expected to be available for the 2017-18 school year. Currently, the ability to finance the projects is contingent on Magnolia's ability to secure bond financing from Hamlin, however Hamlin's closing condition is the charter renewals for MSA 1, 2 and 3.

Plan Disruption – The progress of the capital projects were disrupted by the non-renewals of MSA-1, 2 and 3. As LAUSD announced the non-renewal of the charters, the following reactions occurred:

- S&P downgraded our credit rating from BB/Stable to BB/Negative,
- Magnolia's ability to obtain financing disappeared for MSA-1 as an active charter is a closing requirement for most conventional forms of financing (bonds, loans, etc.)
- Magnolia's ability to obtain financing for other schools has been hindered by association.

Progression Strategy – If we plan to implement our growth plans and expand our enrollment capacity by Fall 2017, we must move forward now. We are in the middle of the charter appeals process and as such we seek charter approval from LACOE (the County) by December 20, 2016. Should LACOE deny the charter applications, we will seek charter approval from the CDE (the State), targeted for May 2017. Whether or not LACOE approves MSA-1,2,3 forces us to create two plans:

***Plan 1: LACOE Approval Obtained* –** If LACOE approval is obtained, then we could move ahead with our planned $18MM bond financing with Hamlin, the investors of our $6.02MM 2014 bonds. We have obtained a term sheet, where they offered to amend the 2014 $6.02MM bond financing to an $18MM (without MSA-7) or $19.5MM (with MSA-7) financing deal.

Over the course of the last fiscal year, the Finance Department has led meetings with multiple financing entities for the express purpose of seeking the best available financing for the capital improvement projects that the organization is undertaking.

Magnolia looked into several options to finance the capital growth plan. Obtaining financing was challenging due to the following factors:

- **MSA-1 Additional Debt Restriction -** Restrictive clauses in the MSA-1 2014 $6.02MM bond deal provided the bondholders (Hamlin) the right to authorize or block additional debt related to MSA-1.

- **Magnolia Has Few Owned Properties -** MSA-1 and MSA-SA are the only schools that own property. Both properties have first mortgage liens on them. Hamlin has the lien on MSA-1 (old parcel supporting $6.02MM bonds) and the state of California has the lien on MSA-SA (Prop 1D program totaling $17.4MM, where 50% is a loan and 50% is a grant).
    - The recently purchased new parcel of MSA-1 has a first mortgage lien to Luxor Properties the seller, pursuant to a $2.8MM seller note expiring in November 2017. This is expected to be refinanced through the proposed $18MM bond.
    - MSA-SD is a leased properties and as such do not have significant assets to be mortgaged or offered to a financier as collateral.

- **Commercial Banking Options -** Magnolia spoke with several commercial banks (East West Bank, Pacific Western Bank, Wells Fargo, Citibank and Banc of California) regarding a bridge loan to finance the capital projects. We were unable to come to terms for numerous reasons: 1) mortgage or collateral was needed, 2) solid evidence of a bond take-out was required and 3) certain banks were uncomfortable with the education sector. Of all the banks contacted, only East West Bank provided verbal interest in doing a short-term bridge loan with bond takeout.

- **Bond Financing Options -** For bond financing we held meetings with the following investment banks, underwriters and financial advisors: Ziegler, RBC Global Asset Management, Piper Jaffray, Nicolas Stifel, Turner Agassi Charter School Facilities Fund and Charter School Capital. No term sheet was issued due to:
    - Lack of pledge-able collateral,
    - Hamlin's (MSA-1) additional debt restriction clause,
    - To buyout the MSA-1 Hamlin bonds, we would have to pay defeasance, which was estimated to be a fee of between $1MM to $1.5MM depending on interest rate fluctuations,
    - News articles regarding Turkey's Gulen,
    - Charter renewal issues at MSA 1, 2 and 3,

Our conclusion was that the only economically and technically viable option was to seek further financing with Hamlin, the sole holders of MSA-1's 2014 bonds.

The term sheet that was provided to Magnolia generally mimics the terms in the 2014 bonds, however there are a few key proposed alterations:

The Borrower will become an Obligated Group including MSA-1, MSA-SA and MSA-SD. The term is 30 years and the interest rate is 6.25%. It is noted that the current interest rate environment is that of increasing rates. A market deal is close to 6.00% at the current moment, which could be even greater than 6.25% by the time we fund. We can lock in the 6.25% interest rate if the term sheet is approved and signed before February 1, 2017.

Plan 2: LACOE Denial Leads to CDE Charter Approval in May 2017 – In the case that LACOE denies the MSA-1,2,3 charters, we will seek approval from the CDE on May 11th 2017. Should this scenario occur, our planned financing with Hamlin will not provide funds in time to keep us on schedule to complete our capital projects by Fall 2017, since charter renewals are a closing condition for Hamlin. In this scenario we plan to self fund the early stages (up to the end of February 2017) of MSA-SD and MSA-SA and delay the MSA-1 project for a year. We also plan to obtain a cash flow loan from Charter School Capital ("CSC") in March 2017. In preliminary conversations, CSC stated that they could provide a loan secured by a revenue pledge in the 9.5% range. Although the interest rate is high, the cash interest amount could be lessened by a rapid payback schedule.

MSA-SD - MSA-SD has a total project cost of $1.5MM assuming that portable classrooms are leased and not purchased. Through the end of February 2017, $171k of soft costs and $350k of hard costs (total of $521k) must be paid to keep the project on schedule. As of 10/31/2016 MSA-SD had $525k of unrestricted cash, $375k of cash after a 5% liquidity reserve and $241k in cash after the 5% liquidity reserve and –$134k of operating losses. We believe that MSA-SD has enough cash to keep the project schedule on time using their own cash to March 2017, at which time a loan from CSC could be obtained.

The cash positions of MSA-SD and MSA-SA are as follows:

Cash Analysis *10/31/16*	**MSA-SA Amount**	**MSA-SD Amount**
Total Restricted Cash	**496,529**	**184,097**
Unrestricted Cash	**468,449**	**525,332**
Total Cash	**964,978**	**709,429**
5% Reserve	**111,858**	**150,449**
Unrestricted Cash After Reserves	**356,591**	**374,883**
Operating Income (Nov - March)	**(542,640)**	**(133,815)**
Excess Cash after Ops	**(186,049)**	**241,068**

MSA-SA – MSA-SA has a total project cost of $3.3MM. Through the end of February 2017, $110k of soft costs and $857k of hard costs (total cost of $967k) must be paid to keep the project on schedule. As of 10/31/2016, MSA-SA $965k of unrestricted cash, $374k of cash after a 5% liquidity reserve and -$186k after operating losses. MSA-SA will not have sufficient cash to pay for the expenditures that are needed to keep the project on schedule. **We recommend that up to $967k of intra-company loans from MSA-8 (alternatively MSA-4,5,6) be prepared to pay for the hard and soft costs required to keep the project on schedule until a loan from CSC could be obtained in March 2017.**

Cash Analysis *10/31/16*	MSA-4 Amount	MSA-5 Amount	MSA-6 Amount	MSA-8 Amount	Combined Amount
Total Restricted Cash	**54,184**	**94,289**	**53,323**	**31,381**	**1,287,153**
Unrestricted Cash	**395,912**	**673,702**	**439,178**	**1,612,256**	**5,379,291**
Total Cash	**450,096**	**767,991**	**492,501**	**1,643,637**	**6,666,443**
5% Reserve	**96,476**	**69,431**	**69,864**	**260,330**	**2,200,488**
Unrestricted Cash After Reserves	**299,435**	**604,271**	**369,314**	**1,351,926**	**3,178,802**
Operating Income (Nov - March)	**49,763**	**(72,544)**	**(7,757)**	**(283,833)**	**(2,232,618)**
Excess Cash after Ops	**349,198**	**531,727**	**361,557**	**1,068,093**	**946,185**

We also wanted to ask the Board for their thoughts on using the 5% liquidity reserve in emergency situations for capital projects to keep them on schedule.

Motion: We are looking for the motion to include board action to approve the capital improvement projects and budgets for MSA-1, MSA Santa Ana and MSA San Diego; and for us to proceed with internal intra-company loans to address cash flow needs through March 1, 2017 or until longer term external financing can be put in place.