ExED

20 YEARS OF EXCELLENCE

NMTC for Navigator Watsonville

April 2020

Charter school facility finance programs

	New Markets	Charter School Facilities Program (CSFP)	Tax Exempt Bonds	CDFI Lenders	Private Lender
Current rate	± 4.7%	2-3%	± 4-6%	± 6.25%	± 9%
Loan To Value (LTV)	100% +	Grant calculator	100%+	70%	100%
Required reserves	Deal by deal	none	±1-year debt service	Deal by deal	Deal by deal
Term	4 years here	30 years	30-35 years fully amortizing	Typically 5-10 years	Typically locked for 3 years
Free Money?	± 30% anticipated debt forgiveness after 4 years	Half grant half loan; prevailing wages required	N/A	N/A	N/A

Why Use the New Markets Tax Credit for Facilities?

- Lowest cost financing for up to 100% Loan to Value
  - Banks max out at 50-65% of value
  - Financing 65-100% of value (mezzanine or equity) is typically expensive
- Reduce need for philanthropy
- Fixed rate for 7 years usually, though here only 4 years remain
- Back end grant reduces amount that must be refinanced

NMTC Background

- Created in 2000 as part of the Community Renewal Tax Relief Act
- Works only in Low Income Communities –typically <60% median income
- Administered through the CDFI Fund, within US Treasury
- Stiff competition for allocations; charter school allocations getting tougher

How the NMTC Works

- 39% tax credit on total investment over 7 years
    - *7-year clock started Aug 24, 2017, and ends Aug 24, 2024*
- Credit based on Investor's cash investment
- To obtain market rate yields, investors leverage their investment with loans, but:
    - loans are to Investor entity, not to Project
    - these loans must be repaid

NMTC intro videos:

https://www.youtube.com/watch?v=E9EXITaOtV0 (general intro)
https://www.youtube.com/watch?v=UIU7TqJNvgg (accountants explain leverage structure used to blend capital at upper tier investment fund)

The Back End

- 2017 tax reform made NMTC credit is *less valuable* to investors
    - Good news: this investment was made in Aug 2017 before credit price dropped.
    - 30% potential forgiveness shown here is better than what schools can get now, due to drop in value of credit to investors
- After 7 year tax credit period NMTC investor can “put” investment fund interest to school for $1000
    - non profit needed to avoid “relief of indebtedness” income
- If Investor does not exercise put, school has option to purchase investment fund for FMV
    - FMV depends on difference between loan rate and then-prevailing interest rates
    - The lower the rate, the more likely FMV will be low or nominal

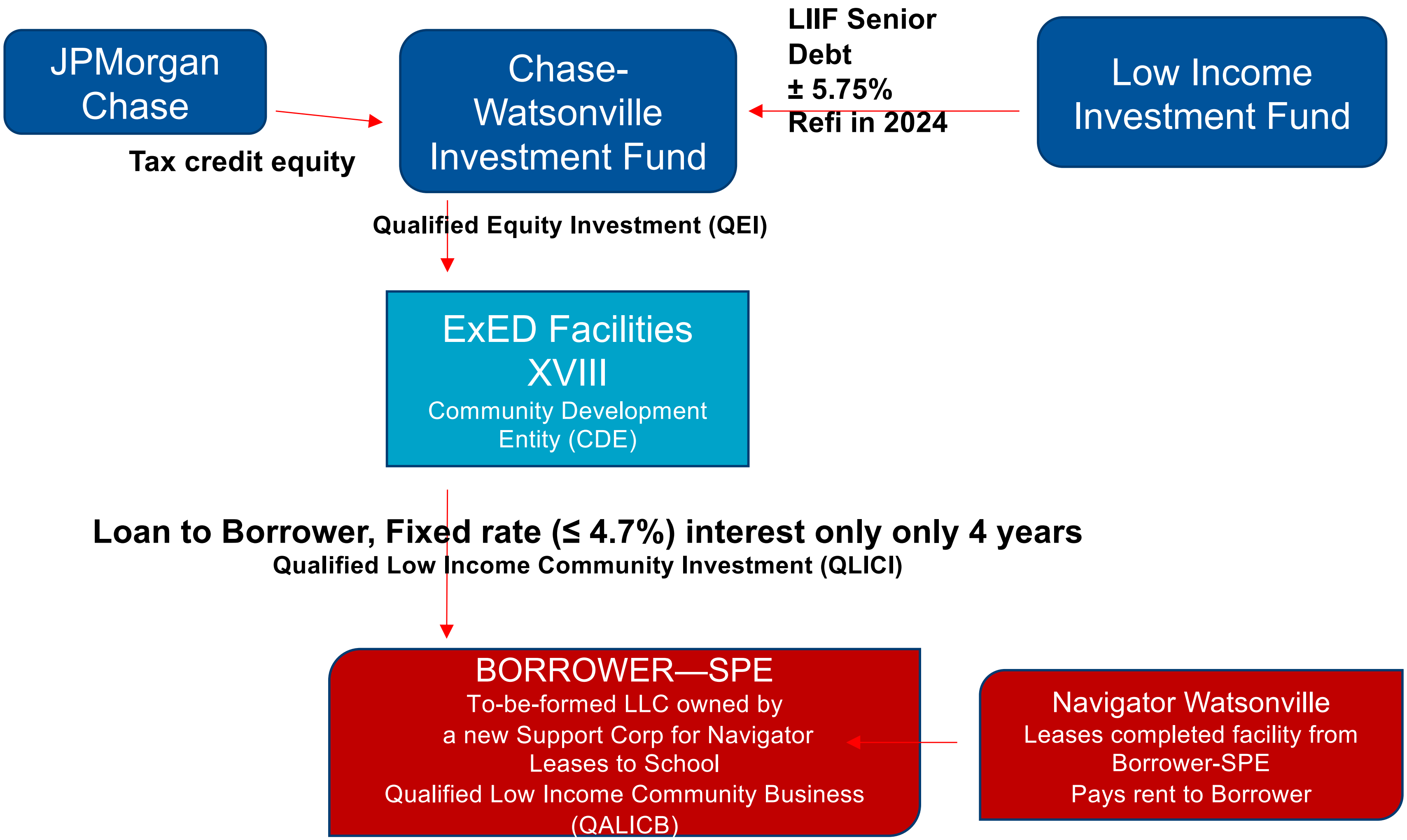
ExED Fees

- To obtain the NMTC investment ExED must indemnify investor against certain risks, particularly “recapture” of the NMTC credit
- To justify these risks and cover program costs, ExED typically gets:
  - 2% fee paid up front at closing, plus
  - 3% fee at back end, paid after 7 years
  - 10-15 bps asset management fee per year (.7-1% total over life of credit)
  - Other incentive fees negotiated on case by case basis
- Industry standard: total fees over life of credit ±8-9% of Loan. ExED believes its fees (≤6%) are among lowest in the market.
- ***Revised structure applicable here***:
  - No up front fee to ExED
  - 3% fee is already funded by cash in loan loss reserve, not paid by Borrower or Navigator
- Fees more than offset by anticipated loan forgiveness in year 7 (± 30%)

Special Purpose Entity

- NMTC lenders require “borrower” to be a special purpose entity (SPE) separate from school operator
  - Can be developer, for profit, or non profit entities
- Borrower leases project to Charter School which pays rent to Borrower
  - Required by SB 740 regulations for facility reimbursements
- Borrower borrows capital from ExED Facilities, pays debt service

Deal Structure



Basic Numbers

SOURCES & USES					
QLICI Note A		3,992,424	lease related costs	40,000	
QLICI Note B		1,707,576	construction	8,046,000	
	TOTAL	5,700,000	HC contingency	327,375	4.1%
Navigator Direct Loan		2,800,000	soft costs	429,125	
			soft cost contingency	39,500	
			Financing Costs	196,000	
			Lender Fees	80,000	
Sponsor Equity % of Project Costs	8.6%	800,000	Capitalized interest	142,000	
Total Sources		**$ 9,300,000**	**Total Uses**	**$ 9,300,000**	

Estimated Annual Cost

Debt Service	Annual Pmt	Rate	Amortization	Term - Years	Repayment
A Note	185,483	4.65%	no	4.40	Yes
B Note	79,332	4.65%	after compliance	30	Put - $1,000
Payments for NMTC Loan	264,814				
Direct Loan	155,000	2.75%	interest-only blended rate		

Total Costs including rent	Annual Pmt	Per seat
ground rent FY 2020-21	-	0
QLICI Debt Service	264,814	490
Direct Loan	155,000	287
Other Borrower costs (E&O, accounting)	5,000	9
INITIAL	$424,815	$787
SEATS IN THIS YEAR	240	$1,770

Direct loan detail		
Navigator loan	2,800,000	
amortization	25	years
rate	2.75%	

Estimated QLICI Interest		
LIIF debt service	229,564	
Asset mgmt fee	6,000	0.11%
servicing	14,250	0.25%
CDE Expenses	15,000	
total	264,814	
estimated rate	**4.65%**	

5-year during ramp up and lease concession in early years

	2021-22		**2022-23**		**2023-24**		**2024-25**	
	Total	Per seat	Total	Per seat	Total	Per seat	Total	Per seat
Ground Rent	80,000	$148	180,000	$333	260,000	$481	320,000	$593
QLICI Debt Service	264,814	490	264,814	490	264,814	490	264,814	490
PCSD Debt Service	155,000	287	155,000	287	155,000	287	155,000	287
Other QALICB costs (E&O, accou	5,000	9	5,000	9	5,000	9	5,000	9
AT CAPACITY	504,815	$935	604,815	$1,120	684,815	$1,268	744,815	$1,379
SEATS IN THIS YEAR	300	$1,683	360	$1,680	420	$1,631	540	$1,379

Construction costs not yet final. Affordability is best assessed by cost per seat.

Site complexity: the ground lease

- Lease is still being negotiated, but rent has been agreed to.
- After year 7, rent goes up 2%/yr.
- Total cost to school is sum of rent to LL + debt service.

LEASE YEAR	SCHOOL YEAR	TOTAL ANNUAL RENT	MONTHLY RENT
1	2020-21	$0.00	$0.00
2	2021-22	$80,000.00	$6,666.67
3	2022-23	$180,000.00	$15,000.00
4	2023-24	$260,000.00	$21,666.67
5	2024-25	$320,000.00	$26,666.67
6	2025-26	$400,000.00	$33,333.33
7	2026-27	$408,000.00	$34,000.00

- To date ExED has financed 34 schools, 16,587 seats using the NMTC. About 20% of these projects have been situated on land leased from a third party landlord, as Navigator proposes to do.
- Schools have been able to finance out of our program with their leased assets.

Program Rules—can the investor lose the credits?

- Investment must remain outstanding for 7 years
  - Foreclosure OK if lender recovers property.
  - Cash received through foreclosure must be reinvested within one year
- 98% of the proceeds must be used to fund a ”Qualified Low Income Community Investment” (QLICI) and 85% must remain outstanding for 7 years
- Lender must reasonably expect the borrower to remain in the qualifying census tract.
- The Borrower must remain a “qualified low income community business.” However an SPE formed to own real estate is not required to have employees.

These risks are easy to mitigate if the deal is properly structured. However if the rules are not met, the investor loses ALL credits, not just a pro rata share of credits depending on when the rules were breached.

Once a loan closes the biggest risk of recapture occurs if a school fails to pay its lease. Investors require schools to indemnify against loss of credits caused by school default.

2024 Refinance

- Underlying real estate is leased; loans obtained by the tenant to finance TIs must be paid by the end of the lease.
- Pacific Charter School Development (PCSD) and the Charter School Growth Fund (CSFG) are making loans to Navigator to facilitate the loan from Navigator to the Borrower. Both PCSD and CSFG also expect to be paid off in 2024.
- To succeed:
  - Navigator must complete the renovations, relocate, and demonstrate results in the new location, as measured by enrollment, finance and the other metrics used to gauge school performance.
  - Capital markets need to settle down. Capital market appetite for charter school debt right now is tepid.

Program Experience to date

- 34 schools financed, 16,587 total seats.
- Exit strategies have varied:
  - Alliance, Green Dot and KIPP combined the schools we financed with other schools in their networks for “Obligated Group” financings—schools in the same network agree to be liable for each other’s debt service. Larger deals are cheaper, mostly due to liquidity risk. These deals are typically fully amortizing over 30 years.
  - Camino Nuevo opted for tax exempt financing directly purchased by Wells Fargo. CNCA’s rate is lower than the OG financings, but it must refinance in 10 years.
  - Our first “one off” single school refinancing was Watts Learning Center, about $4.5MM. WLC had many options, including 30 year debt through the bond markets, but opted for a loan from a credit union at 4.4%, due in 7 years.

Discussion