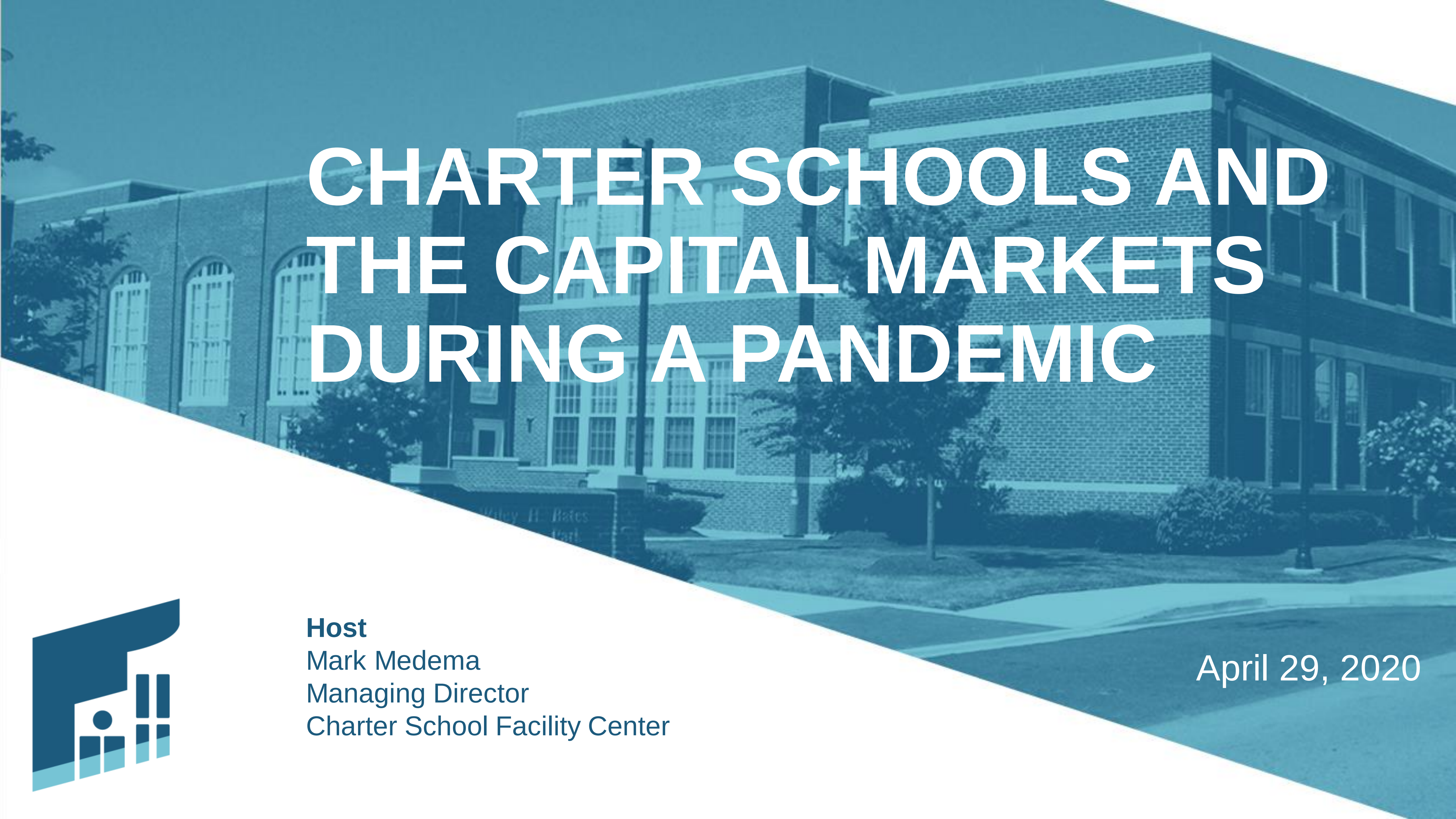

CHARTER SCHOOLS AND THE CAPITAL MARKETS DURING A PANDEMIC

Host
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Managing Director
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April 29, 2020

SPEAKERS

Liz Sweeney, President, Nutshell Associates LLC
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- Registered Municipal Advisor and financial consultant
- Specialties: credit ratings, rating agency & investor relations, methodologies & scorecards, portfolio risk
- Board member, University of Maryland Medical System
- Faculty, Georgetown University, Washington DC

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- Investment banker specializing in financing charter schools in the northeast and Florida
- Has led over 30 charter school bond issues providing more than $750 million to charter schools
- Former Board Member of the Charter Schools Development Corporation

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- Founder of Wye River Group, over 35 years experience providing financial advisory services to nonprofits, governments, and authorities
- Served as financial advisor or lead banker on over 200 capital financing and planning engagements and over 800 transactions in 30 states and the District of Columbia

Laura Kozel, Vice President Capital Finance, Rocketship Public Schools
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- Oversees capital finance for Rocketship, operator of 19 charter schools in CA, WI, DC. and TN
- Background in commercial real estate, credit, and valuation
- Former charter school board member, AZ School for the Arts

CHARTER SCHOOLS AND THE CAPITAL MARKETS

Today’s Topics

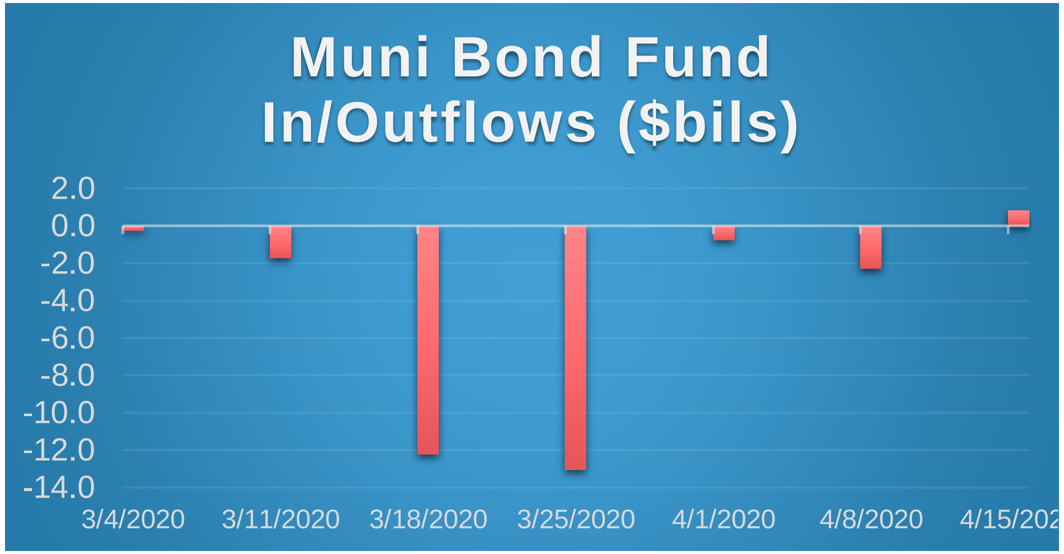
Capital markets reaction to COVID-19
Implications for charter schools’ access to capital
Short-term and long-term risks
What can proactive charter school leaders do?
Best practices for communicating with key stakeholders
Q&A

CAPITAL MARKETS REACTION TO COVID-19

Pre-COVID	Now
Strong economy, low unemployment	Weak economy, high unemployment
Low municipal interest rates	Municipal rates spiked, then settled, but traders report thin liquidity and wide bid/ask spreads
Bond issuance down (supply down)	New bond issuance very light; big overhang of issues on the sidelines (supply up)
Money flowing into municipal bond funds every month for 5 years (demand up)	Investors withdrew record amounts from municipal bond funds; traders sold bonds at lower prices (demand down)
Risk premiums (spreads) for low rated/nonrated very low	Investors want more compensation for risk
Benign credit environment; sector outlooks mostly stable	Downgrades have started, will accelerate, almost all sector outlooks are negative
Result: Lower rated / nonrated borrowers enjoyed the best environment in a generation	Result: Access to capital is more challenging, more expensive and uncertain

MUNICIPAL MARKETS

Rush for the Exits Caused Selling Pressure



Source: Lipper

Change in 30-year MMD *		
Date	Rate	% change
March 9 (Low)	1.38%	-
March 20 (High)	3.37%	+144%
April 23 (Current)	2.08%	-38%

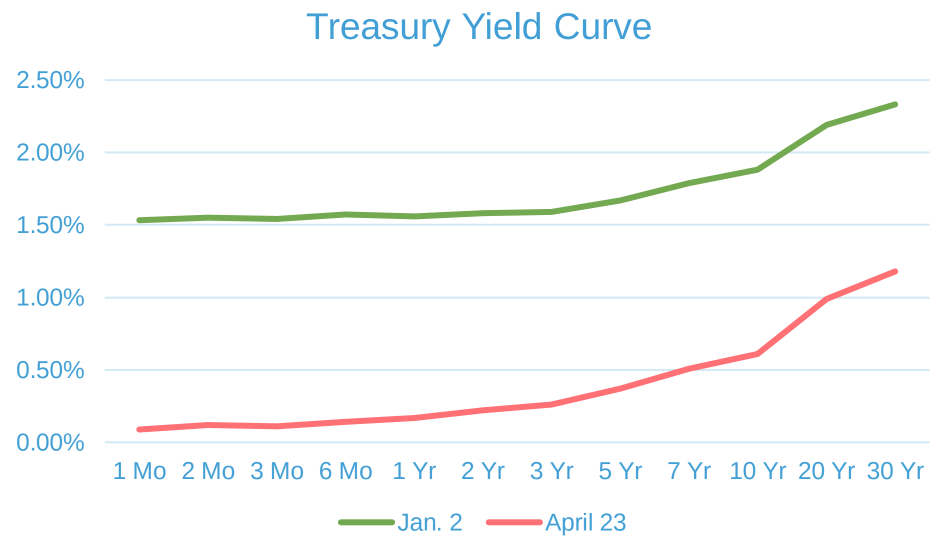
* MMD is an index of ‘AAA’ rated municipal bonds. Source: Refinitiv

Why it matters: Selling bonds to meet redemptions causes prices to decline, yields rise

Why it matters: market volatility spooks both investors and borrowers

STOCK AND BOND MARKETS

Then and Now



Dow Jones Industrial Average

Why it matters: investment returns, pensions assets & liabilities

Why it matters: philanthropy, pensions assets & liabilities

CREDIT ANALYST VIEWS

Short-Term and Long-Term Views Diverge

Short-term: Not too bad!

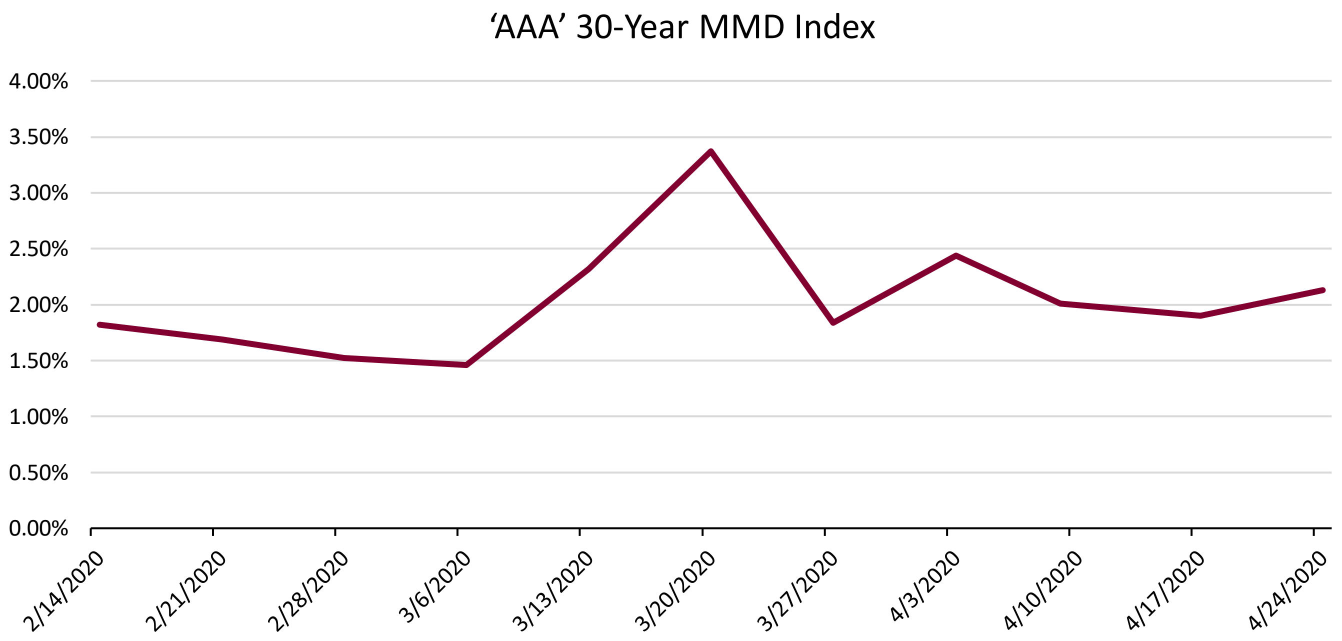
- Increased costs of transition to remote learning; mostly offset by lower operating costs for energy, maintenance, transportation.
- State aid continuing to flow this fiscal year
- Schools receiving necessary waivers for testing, academic performance, etc.
- Relative to many other public finance sectors, this is a very good story

Long Term: Increased Funding and Demographic Risks

- Risk of reduced per pupil funding and funding delays from tapped-out state governments
- Potential shifts in demand as local demographics and economies change
- At greatest risk: schools with low liquidity, thin debt service coverage, limited fund raising

IT'S NOW AN INVESTOR'S MARKET

- Investors pulled > $40 billion from municipal bond funds since early March
- New bond issuance fell > 40% in March and April
- Benchmark MMD index was extremely volatile in March; has settled down in recent weeks
- Credit spreads have widened considerably ***particularly for non-rated credits***
- What was a "Borrower's Market" is now an "Investors Market"



Source: Bloomberg and Lipper Analytical Services – Week ending April 24, 2020

RISING COST OF CAPITAL - EXAMPLE

What Does the Current Market Mean for a School With a $20 million project?

- In this example, a charter school requires $20 million net proceeds for its project fund
- Compared to pre-COVID market, the school needs to issue almost $2.0 million more bonds to net the same $20 million project fund
- The school will pay higher interest rates for two reasons:
  - Risk free rates (MMD) re higher
  - Credit spreads are wider
- Total interest paid over the 30 years: $5.4 million more
- Total payments over the 30-year period: $7.3 million more
- Budgetary impact: The school will have higher monthly payments of about $20k and higher annual payments of about $245k

	Pre-COVID-19	During- COVID-19	Change
Par Amount Issued	$20,815,000	$22,745,000	$1,930,000
Debt Service Reserve Fund	1,344,850	1,589,600	244,750
Estimated Costs of Issuance	614,490	644,207	29,717
10 Year Bond Yield	3.35%	5.00%	1.65%
20 Year Bond Yield	3.95%	5.63%	1.68%
30 Year Bond Yield	4.07%	6.00%	1.93%
Average Coupon	4.94%	5.82%	0.88%
Total Interest Cost	4.58%	5.97%	1.39%
Average Spread of MMD	+218 basis points	+406 basis points	+188 basis points
Average Monthly Payment	$111,848	$132,243	$20,395
Average Yearly Payment	1,342,173	1,586,915	244,742
Total Interest over 30 Years	19,390,562	24,791,933	5,401,371
Total Interest over 30 Years	40,205,562	47,536,933	7,331,371

KEY TAKE AWAYS

The Tax-Exempt Bond Market Is Still Open for Charter Schools

- Mutual fund investors still have money to invest, but are more cautious
- Institutional investors still interesting in charter school transactions
    - But at a cost: wider spreads and higher rates
- Value of credit ratings is rising
    - Especially for investment grade or high non-investment grade
- Credit fundamentals will now be far more important than in the past
    - Additional scrutiny of financial and operational metrics (coverage, liquidity, enrollment, wait lists, retention, charter status, authorizer relationship, state funding, etc.)
    - Investors will be taking a much “deeper dive”
    - It may take a little longer to market a charter school bond issue

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PLAN OF FINANCE CHALLENGES

- Significant Change in Public Market Dynamics
  - Lower Investor Demand
  - Higher Credit Spreads
  - Significantly Higher Borrowing Cost Now vs. Two Months Ago
    - Non-Rated: + 175-200 BPs
    - Low Investment Grade (BBB): + 100-125 BPs
- Increased Interest in Financing Alternatives
  - Bank-Purchased Bonds
  - CDFI Financing
- Key Considerations
  - Timing of need
  - Amount of capital required
  - Per-pupil reimbursement environment
  - Borrower’s financial strength

COMPARISON OF LONG-TERM FINANCING ALTERNATIVES

	Public Offering	Bank Bond (or Loan)	CDFI Loan[2]
Rate Commitment Period	Up to 35 years	Up to 15 years	Up to 10 years
Amortization Period	Up to 35 years	Up to 30 years	Up to 10 years
Interest Cost	4.50 – 5.50% (35/35)	2..30 – 2.80% (10/30)	4.00 – 6.50% (5-10/10)
Financing Amount	Up to 100% of Project Cost	Up to 75-80% of Project Cost	Up to 75-80% of Project Cost
Reserve Fund Requirement	Yes	No	No
Transaction Costs	0.75–1.5 of principal amount + $350–500,000	$250–400,000	$150–300,000
Prepayment Limitations	7-10 year make whole	Full term make whole	Full term make whole
Feasibility Basis	Projections acceptable	Historical financial performance	Projections usually acceptable
Financial Covenants[1]	Generally most liberal	Generally most restrictive	Less restrictive than banks
Typical Financing Range	$20 million +	5-20 million	$1-10 million
Public Disclosure	Yes	No	No
Credit Rating	If possible	No	No

(1) *Key covenants include Debt Service Coverage, Liquidity and Limitations on Additions*
(2) *Select CDFIs will offer longer term solutions*

FINANCING STRATEGIES GOING FORWARD

Maintain Flexibility

Synchronize Financing Planning with Timing of Need

✓ Manage process based on key factors
- New policies governing school operations
- Per-pupil reimbursement amounts
- Operating projections/financial feasibility

✓ Establish project cost/timing alternatives

✓ Establish primary and fallback plans of finance

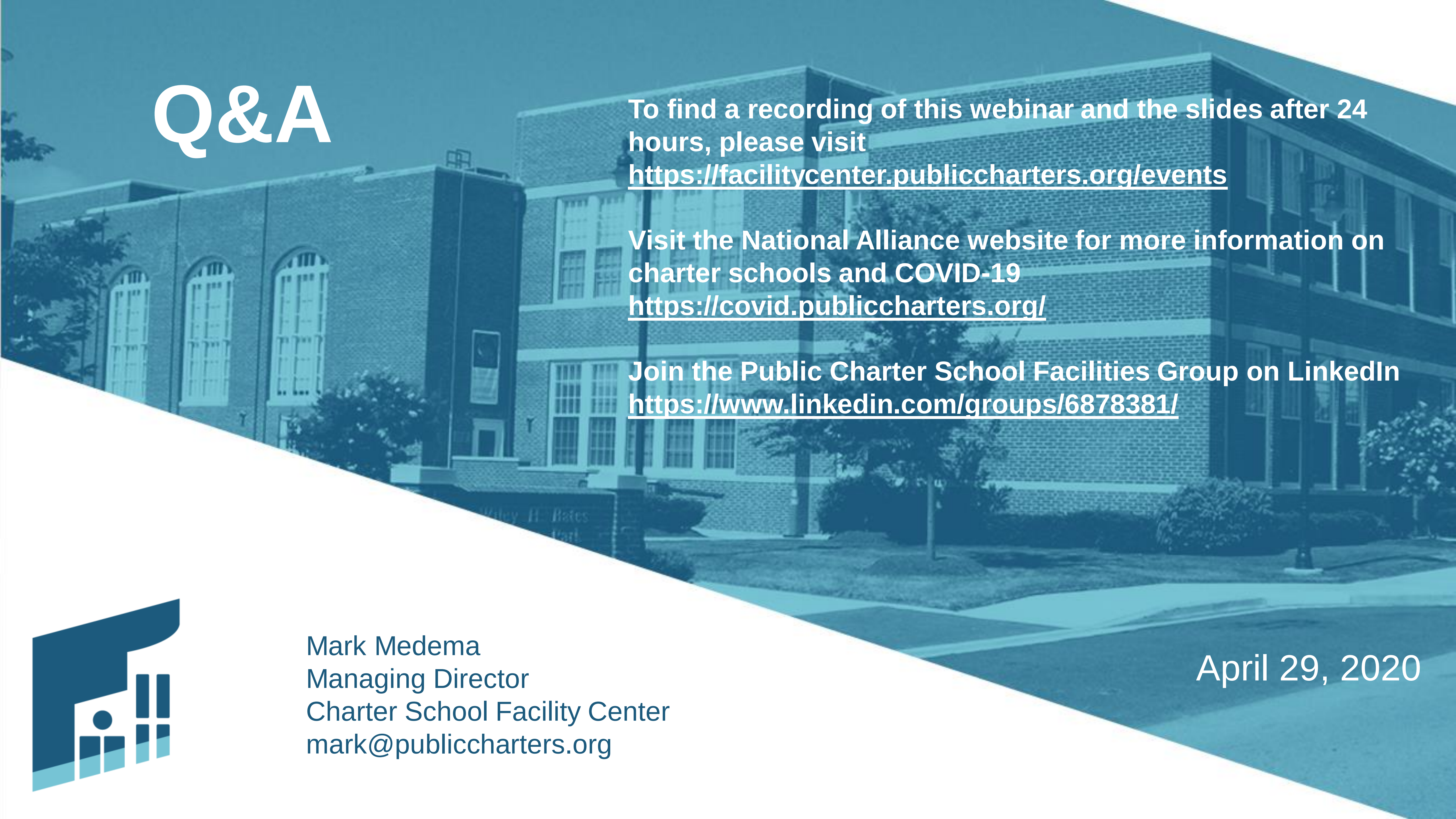
Conduct Competitive Solicitation of Multiple Alternatives

✓ Permanent Financing
- Underwriters – Bonds
- Banks – Bonds or Taxable Loan
- CDFIs - Loan

✓ Interim Financing
- Banks
- CDFIs
  - Short Term Bridge Loan
  - Long Term Variable Loan
  - Intermediate (2-3 yr.) Fixed Rate Loan

✓ Establish actual availability/cost/terms as close as possible to target close date

Q&A



To find a recording of this webinar and the slides after 24 hours, please visit
https://facilitycenter.publiccharters.org/events

Visit the National Alliance website for more information on charter schools and COVID-19
https://covid.publiccharters.org/

Join the Public Charter School Facilities Group on LinkedIn
https://www.linkedin.com/groups/6878381/

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