

Look Your Best to a Lender

By Adam Miller, Senior Vice President of Strategic Partnerships, EdTec Inc.

A facility of your own, designed to reflect and to support your school's unique model, community, and students, is the dream of many charter school leaders. Like most dreams, wishing upon a star is not enough; it takes a lot of hard work and planning to make a facilities project come to fruition. Further, you'll need to get someone else to believe in this dream since it costs millions of dollars to purchase and/or build your own site. To successfully get a lender to help turn your vision into a reality, the work begins years before you break ground.

In this article, we'll explore the criteria that a lender will use to determine whether your school is a good investment. After reviewing how the lender will examine your school, we'll discuss tips to look your best before going under the microscope.

Four C's of Lending

To get to know your school, a lender will ask for a host of documents including your past, current, and future financials, prior audits, charter petition, bios of board members, and enrollment reports. It may feel like lenders are pouring over every bit of minutia, asking questions about small details to which you've long forgotten the answers. All this probing is not to find a tiny bit of information to trip you up, but rather to develop a big picture of your charter school.

Lenders synthesize your information into four categories, which helpfully all begin with the letter C. Through the Four C's of Lending: Character, Competition, Collateral, and Credit, lenders evaluate your school and your project. Since your dream facility depends on you getting an A on the Four C's, let's understand them better.

Character

A lender wants to make sure that the high character you are teaching your students is also reflective in your school's management. Lenders will take a close look at the capabilities of your leadership team, including staff, board members, and any high level consultants (e.g. EdTec).



The lender wants to know that the school leadership has the skills and experience to manage a high performing school, a small business, and a facility project – all at the same time. The lender will assess this through examining biographies, reviewing board minutes and organizational documents, and conducting interviews.

Besides the school leadership, of special concern is the facilities project team. Any lender or investor in the school will need to feel comfortable that the architect, general

contractor, and other members of the facilities project team can deliver a high quality project that the school can move into on time and that will last at least as long as the loan.

Credit

Besides having a team that can keep the school thriving and manage a facilities project, the school also needs to be able make its loan payments on time and in full.

The lender will try to construct a complete picture of your financial health by reviewing your historical financial performance, your most recent financial statements, and your financial projections. Potential lenders will want to understand your operations, your history of producing a positive operating income, and your current cash available. Further, they'll need complete details of any outstanding debt to ascertain if those loans will make it more difficult for you to take on additional debt and whether it will affect the new lender's ability to take radical action if the school closes.

An initial calculation a lender will perform as a proxy for your ability to service your debt is the Debt Service Coverage Ratio ("DSCR"). DSCR is calculated by taking your Total Revenue (from all sources) minus Total Expenses divided by the annual loan payment for the proposed loan. For example, if your school's revenue is \$5,000,000 and your expenses are \$4,600,000, this is an operating income of \$400,000. If the annual loan payments are \$300,000, then the DSCR is $\$400,000/\$300,000 = 1.33$. Most lenders will look for a DSCR of around 1.25 or higher, although EdTec has seen lower.



Your expenses will be reviewed and compared to standard expenses at other high performing charter schools. You should be prepared to explain any unique line items in your budget; either standing out because of a special feature at your school or for higher or lower expenses than would normally be seen. Further, you should be able to show where there may be some room in your budget that would allow you to make cuts in case you don't meet your enrollment targets. The lender is not only trying to understand how your expenses may change as your school grows, but also wants to make sure that even with the facilities debt you will be able to continue to fund all the unique programs and staff that make your school a success.

Competition

To make a loan to your school, be it for 7, 10, or 30 years, the lender needs to believe your school will be around for at least the length of the loan. Your historical financials may be solid, your leadership team can be outstanding, but other threats are still out there. You need to show you have the ability to navigate these outside threats (i.e. survive in a "competitive" landscape).

The first threat, which is likely never far from your mind, is your authorizer. Not only is your charter up for renewal every five years, but the authorizer can revoke your charter. The lender will want to understand your authorizing environment and relationship. That California has an appeals process, making you less susceptible to shifts in local political winds, does give the lenders an amount of comfort. However, if you've already been through a renewal once, that will provide additional assurance.

The second threat is losing enrollment, which means losing revenue. The lender will want to know that there is high demand for space in your school (i.e. waitlists) and to see that there haven't been enrollment issues in the past. Further, they'll want to see consistent high academic performance, as that is a likely driver of continued demand for your school. Lastly, they'll look closely at the performance of other schools in your area. One reason is to confirm that you are a high quality option for families in the area, and that you won't lose out to district or charter school competitors. The second reason won't make you feel all warm and fuzzy, but the lender also wants to know that if something happens to your school, that there would be demand for another charter school to move into the space and take over your mortgage.

Collateral

Collateral is the value of what you pledge to repay the loan. The obvious example is the appraised value of the property. The lender assesses risk for this type of collateral by looking at the Loan to Value ("LTV"). As the LTV of your project increases, so does the perceived risk. LTV is calculated using the assessed value of the property (e.g. \$10,000,000) and the amount of the loan (\$8,500,000). \$8.5 million/\$10 million equals a Loan to Value of 85%. The remaining 15% (\$1.5 million) is the amount of equity that your school puts into the deal. Most lenders will be looking for LTV from 70% to 90%, although charter schools have issued tax exempt bonds at or over 100% LTV.

Besides the property, there are additional sources of collateral that you can pledge to the lender to make the loan happen or lower the cost of borrowing. These sources include credit enhancement from programs such as CCSA's California Charter Building Fund, a letter of credit from a bank, or a guarantee from a high net worth friend of the school.

Four Tips on the Four C's

Passing the test on the Four C's is an essential step to getting the loan to make your dream facility come true. To score well, you can't cram for this test. Success is dependent on building a documented track record of strength, competence, and high performance.

Your school can set itself on the right path from even before the doors open. Below are four tips that by following you'll be getting in shape from day one to pass the Four C's and take that big step to your dream facility.



1) Build a Diverse and Talented Support Team

Before your charter is even approved, you can start building a team that has the skills and capacity to successfully complete a charter school facilities project. You can seek out experts in a variety of areas such as finance, real estate, law, community and government relations, and project management. These key skill sets will be invaluable as your charter faces non-facility challenges as well, yet another reason to begin building your diverse, talented team early.

While you can certainly hire professionals in all of these areas, you can begin by building a network of volunteers with these specific skills. Spread the word among staff, parents, and supporters that you are

in need of these skills to help make your school thrive. The obvious place to integrate these highly skilled volunteers is through the Board of Directors. However, often that level of commitment and responsibility may not be for everyone. Further, the limit of your number of board members would then limit the number of volunteers. To address this need, consider adding committees to your board that will allow non-board members to share their expertise and become integrated into the school committee.

When you do need to supplement your team with paid professionals, besides assessing their general expertise, you should make sure they fit your charter's specific needs, for example:

- Do they have experience working with charter or K-12 schools?
- Have they worked in the local area? Local knowledge may be key to getting plans approved.
- Are they interested in your mission? You live and breathe your school every day; anyone you hire should support its mission.
- Can they meet outside of "business hours"? The demands on a school leader while school is open often do not accommodate set meeting times. It's helpful if the consultant has flexibility to meet before or after the school day.
- Do the billing terms mesh with your cash flow? Sometimes delays from the state force delays in payments to consultants. It is helpful if your consultants understand this.



Bringing talented people into your school community will help your school thrive and convince a lender that you have the ideal character to be a successful borrower.

2) *Build a Fundraising History*

To make the numbers work for a facilities project, often charter schools put in a sizable line item for fundraising. Let's say School X can only afford a \$5 million facility. Their dream facility will cost \$6 million. Suddenly stories of successful capital campaigns and tales of rainmaking development professionals abound. It is perfectly fine to include fundraising in your project plan, but it must be believable. If your school has never raised more than \$20,000 per year, it's far-fetched to believe that \$150,000 per year is now likely. If fundraising is part of your plan to service your debt, the lender needs to believe that your plan has a near certain likelihood of succeeding.

To include significant fundraising in your budget, you need to establish a track record of fundraising success. Early in your charter's life, make fundraising, from your school or expanded community, an ongoing focus of the school. If you're relying on your school community, show an increasingly higher percentage of community members making donations. You'll want to build a solid foundation to show that fundraising is a core practice at your school and not subject to the whims of a few individuals.

If contributions from foundations or high net worth individuals will be essential for a facility, again start developing those relationships early. The first contact and the first grant award should come well before the need for facilities assistance.

3) Make Student Recruitment and Attendance a Focus

A lender needs to feel comfortable that a charter school's revenue will cover the debt payments for the life of the loan. As enrollment drives charter school revenue, this means creating a track record of full enrollment with a high attendance rate. Full enrollment alleviates concerns about your school's ability to succeed in a competitive environment.

Many will see goals of full enrollment and high attendance percentage and think that every charter school tries to reach them. That is true, but the best, most successful charters, are very intentional in setting their enrollment growth plan, devising a strategy to reach it, and documenting the process. High attendance rate is not just a nice thing to have; it is fundamental to school culture at successful charters. Having a focus on full enrollment means being quick to understand and address any dips in attendance numbers. It also means pushing your school to not just reach its goal, but to build a waitlist as a security blanket for the school and reassurance for a lender that the demand for your school outstrips supply.

A consistent, predictable enrollment will make financial planning easier for your school and provide comfort to a lender. Enrollment and attendance strategy and performance discussions should be elevated to the board level as it is central to the financial health of the school.

4) Maintain Political and Community Relations

In the months building up to the hearing for a charter, charter leaders are tenacious networkers and advocates. They lead door-to-door campaigns to educate parents. They meet with school board members, church leaders, city council members, and business leaders. They write letters to the editor, lead public rallies, and inspire foundations to donate. The hard work pays off, the charter is approved, and . . . these new relationships dwindle.

The amount of activity understandably needs to decrease as more time and energy is transferred to opening and operating an amazing school. However, you should have a plan to keep the communication channels with community leaders, politicians, foundations, and your authorizer open. Share the milestones and achievements with them. Keep your school and the good work that you are doing in their minds. Maintain a database with the information of key stakeholders and track when you are engaging with them.

To get a facilities project completed, you will likely need the support of many of these stakeholders. They can speed up approval of plans, build community support for your site, or write a letter of support to a lender. In your charter approval process, you accumulated many of the political and community assets you need to make a facilities project easier. Enrich these assets, don't let them atrophy. It's never fun to have your first communication with someone in a long time be a request for help.

Conclusion

From the earliest days of your charter school, you can start building the foundation of your dream facility. By bringing talented people onto your team, developing a track record of fundraising, creating

and executing a student recruitment plan, and maintaining and building your community relationships, your school will exhibit the character, credit, and competitiveness that is attractive to a lender. It's a long and arduous road to a facility of your own that reflects the heart of your school, but with proper planning and foresight, it can be well worth the hard work and can serve your school community as you continue to grow.

A special thank you to Adrienne Barnes from Capital Impact Partners, Laura Kozel from Rocketship Education, and Jennie Bartkowiak from EdTec for their work on the 2014 CCSA Conference presentation upon which this article is based. 🍃