ZIEGLER INVESTMENT BANKING

CHARTER SCHOOL FINANCE Z-NEWS

FEATURED ARTICLE

TIME TO REVIEW YOUR FACILITIES FINANCE ARRANGEMENTS

As we move into 2018, school leaders should be reviewing any existing financing arrangements in light of developments in the interest rate market and the recently enacted Tax Reform Act. The marketplace is shifting and there may be opportunities for your school to save money, reduce risk or help plan for the future. Let's talk about this changing environment!

The Tax Cut and Jobs Act of 2017

A large segment of the charter school sector has relied upon the use of tax-exempt bonds to finance facilities. While there are other good options available such as developer financing and lease-to-own products, most schools ultimately gravitate towards tax-exempt bonds at some stage of development as bonds are typically the lowest cost long-term solution for facilities finance.

Last fall, the House of Representatives version of the tax reform bill contained a provision that would have prevented 501(c)(3) organizations such as charter schools from accessing the tax-exempt bond market. Thankfully the charter sector mobilized and this provision was eliminated from the final bill. Charter schools are still able to utilize tax-exempt bonds as they have since 1998. That said, there was one casualty contained in the final tax-bill, namely a prohibition on "advance refunding." An advance refunding is a refinance of an existing tax-exempt bond issue before its allowable call date (typically 10 years after issuance). Schools had used the advance refunding tool to refinance existing higher interest rate bonds during times of lower interest rates.

It is important to note that if your school (or building corporation) has bonds outstanding and you are past your allowable call date, you will

	SIX MONTHS PRIOR	CURRENT
5 Yr Treasury	1.76%	2.61%
10 Yr Treasury	2.17%	2.86%
30 Day LIBOR	1.23%	1.60%
Prime Rate	4.25%	4.50%
30-year MMD	2.73%	3.03%

Source: Ziegler Capital Markets
Rates as of February 26, 2018

INTEREST RATE UPDATE

Higher interest rates are finally here after years of predictions that rates must return to historical norms. A healthy economy, booming stock market and changing Federal Reserve policy are all coming into play. When you look at the benchmark indices in the table above, all five of them are up materially over where they were six months earlier. If your organization is planning a project or is in the market for financing, it may make sense to speed up those plans and lock in interest rates.

ABOUT US

Ziegler is a **national leader** in providing **financing** to **charter organizations nationwide**.

Contact us for assistance with **your financing needs**.

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still be allowed to refinance those bonds if it makes economic sense to do so. The prohibition typically only relates to bond issues within their first five to ten years of issuance.

There may be help on the way regarding this situation. On February 13, 2018, U.S. Representatives Randy Hultgren (R-IL-14) and C.A. Dutch Ruppersberger (D-MD-02) introduced legislation to restore the tax exemption for advance refunding of municipal bonds. We will watch this legislation closely and keep you apprised of any developments. While there are no guarantees this legislation will pass, it is possible that charters will be able to again avail themselves of this bond refinancing tool later in the year.

Action Item: If you have existing bonds outstanding, contact a trusted resource such as Ziegler to review the call date on your bonds in order to better understand your refinance options now and in the future.

A second element of tax reform relates to the lowering of the corporate tax rate from 35% down to 21%. Over the past decade a number of large commercial banks had been issuing tax-exempt loans to schools and other not-for-profits. Such loans were issued as tax-exempt bonds but the "bonds" were held by the commercial bank as part of their loan portfolio. Banks enjoyed this practice because the loans were tax-exempt and the interest income was not subject to a 35% corporate tax rate. With the lowering of the corporate tax rate to 21%, the attractiveness of these tax-exempt loans to banks has decreased. There are two important ramifications for schools that are utilizing this structure:

> First - Your loan terms may allow the bank to raise the interest rate on your tax-exempt loan based on the lowering of the corporate tax rate. We've seen borrowers who have been informed that the rate on their loans has gone up by one half to one full percent as of January 1, 2018 due to the tax law change. Many borrowers are learning that they may not have a "10-year fixed rate" or the like that they thought they signed up for. The reality is the rate defined in most bank loan documents has always been subject to tax law changes.
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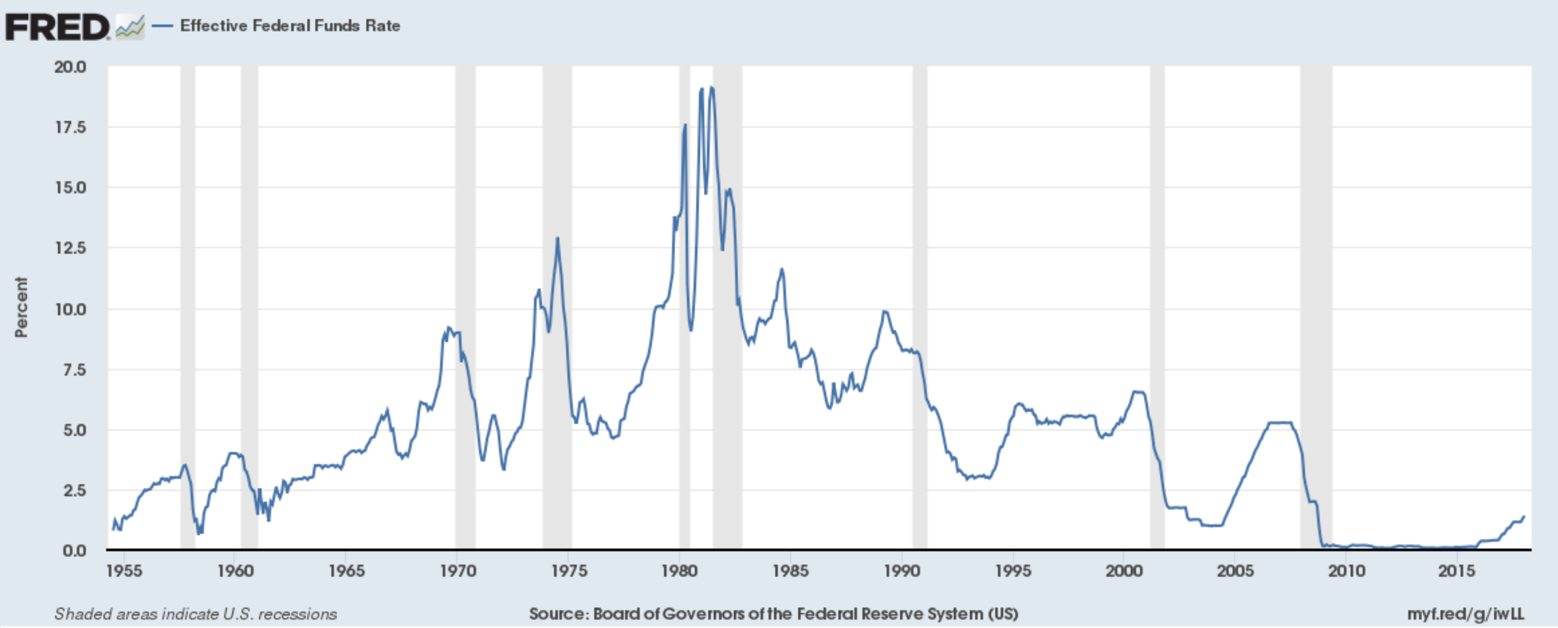
> Second - If your organization utilized an interest rate derivative contract such as an interest rate "Swap" to hedge against rising interest rates on your bank loan, the Swap contract may not meet your desired objective depending on any modifications in your underlying bank interest rate.

Action item: If you have a tax-exempt financing held by a bank, you may want to review the terms and any Swap contracts to see if the economic value of this structure is still attractive compared to other alternatives such as 30-year fixed rate bonds.

Interest Rates are on the Move (upward)!

After the economic recession in 2008, the Federal Reserve engaged in a focused effort to revive the economy and the banking sector. The Fed lowered the Fed funds rate to zero and simultaneously began the purchase of fixed income securities on the open market in an effort to drive interest rates down and spur economic activity. For an-eight year period the interest rate market was relatively benign and borrowers got used to short-term interest rates approaching zero. Over the past 18-months the Federal Reserve has since been actively raising interest rates while simultaneously starting to allow their bond portfolio to run off. The result? Interest rates are starting to move higher, back towards more normal historic levels.



The Fed raised the Fed Funds rate at their December 13th meeting to 1.50%. Commentators expect additional hikes later this year. As you can see by the graph above, the U.S. economy has operated with historically low interest rates since 2008. That appears to be changing and borrowers should take note. One example of this change is the government's bellwether 10-year treasury bond. The 10-year reached a low of 1.37% back on July 5, 2016. On February 21, 2018 it hit a recent high of 2.94%.

Action Item 1: If your school is planning a project, you may want to accelerate that timetable to lock in your interest rate sooner rather than later.

Action Item 2: If your school is leasing its site with an ability to purchase, you may want to examine those options now as organizations such as Ziegler may be able to offer you a 30-year fixed interest rate on any needed facilities purchase financing.

Action Item 3: If your school has a floating rate or short-term mortgage loan you may want to examine options to refinance the note or explore long-term 30-year fixed rate bond financing to lock your rate before rates possibly move higher.

Summary

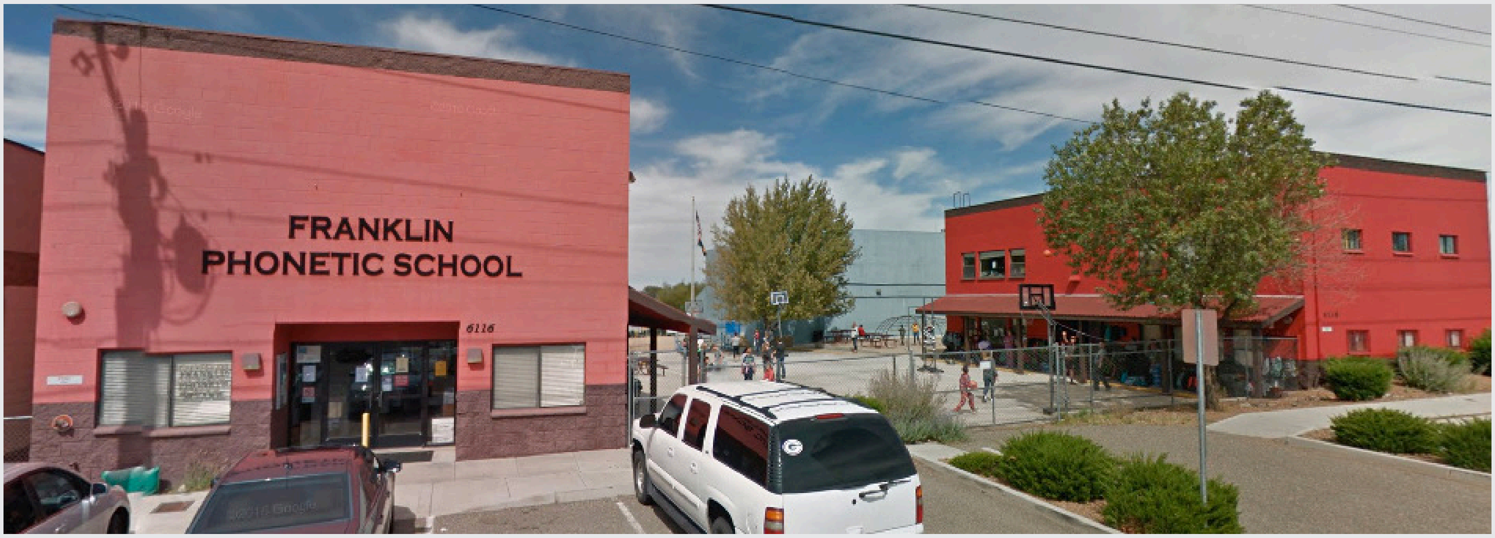
Every dollar a school can save on mortgage cost is a dollar that can be plowed back into the classroom for student programming. Recent tax law changes combined with a rising interest rate environment present certain opportunities that schools should explore. We encourage you to reach out to Ziegler for any questions you may have. We've been working with school borrowers for more than 100 years now and are always available to help.

Scott Rolfs is the Managing Director & Group Leader for the K-12 & Charter School Finance team at Ziegler. Contact us at 800-558-1776 to learn more about facilities finance options Ziegler offers.

CASE STUDY

FRANKLIN PHONETIC CHARTER SCHOOL

$6,715,000, SERIES 2017 REFINANCING & ACQUISITION



Established in 1996, Franklin Phonetic Primary School, Inc. (Franklin or the School) is a public charter school that serves students in grades K-8 in Prescott Valley, Arizona. Franklin first began operating as a charter school in August of 1996 while serving students in grades kindergarten through third. In its first year, Franklin served approximately 103 students. At the close of the 2016-17 school year, Franklin had 465 students, with hopes of growing in the future to about 615 students with the addition of a Pre-K program, now that they have secured ownership of their existing buildings and acquired new property via their partnership with Ziegler.

Franklin is chartered through the Arizona State Board for Charter Schools; in 2011 Franklin received a 20-year renewal to 2031. The school serves a diverse student body located about 90 miles north of Phoenix. Franklin is well known for its academic success as the school was one of two schools in the state of Arizona to be awarded the federal "Blue Ribbon School" designation for outstanding academic achievement. The school strongly emphasizes reading proficiency by using a strong primary phonetic curriculum partially created by school co-founder and current Governing Board Chairperson, Dr. Cindy Franklin. The school's reputation of success with students with special needs has made Franklin a preferred destination for those students. The school currently serves about twice as many special needs students as other schools in Yavapai County. The school believes its long history of success as one of Arizona's oldest charter schools, its reputation for academics, its success with special needs students, the addition of the Pre-K program and the new facilities will allow Franklin to remain competitive for many years to come.

Proceeds from the Series 2017 Bonds were used to (i) pay off a note on a building that Franklin was currently occupying, (ii) refund Franklin's outstanding Series 2006 Bonds, (iii) acquire an adjacent land parcel, (iv) fund capitalized interest and a debt service reserve, and (v) pay cost of issuance.

By working hand-in-hand with the leadership team at Franklin Phonetic, Ziegler was able to provide the ideal financing for the school. Ziegler's investment banking team closely monitored the aspects of the financing to ensure that the financing followed a tight schedule, as the school had a strict deadline on its current lease. Ziegler's capital markets team was familiar with the favorable environment that Arizona provided for charter schools, such as a long charter renewal period and multiple authorizing bodies. When it came time to pricing, Ziegler's team leveraged its niche understanding of the Arizona charter school market to attract multiple investors, ultimately leading to attractive interest rates and affordable debt service.

"Ziegler did an excellent job with our financing. They were able to deliver the financing at low rates and, more importantly, on time, as we were up against a tight timeline for our project"

Dr. Cindy Franklin
Co-Founder and Superintendent
Franklin Phonetic Charter School

This client's experience may not be representative of the experience of other clients, nor is it indicative of future performance or success.