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Empirical Data on the Effectiveness of Partial Credit Enhancement of Tax-Exempt Bonds

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Introduction

- In late 2009 and early 2010, two bond issues were partially enhanced by guarantees of philanthropic organizations and other entities. These guarantees lasted only 10 of the 30+ years of the issues and did not cover all P&I payments during that time.
- These two bond issues were issued on behalf of KIPP Houston (2009, $66 Million in bonds, $20 Million enhancement) and Aspire Public Schools (2010, $93 Million in bonds, $17 Million enhancement)
- These two issues were both rated "BBB", with KIPP's rating from S&P and Aspire's rating from Fitch.
- Within 1-3 weeks of these enhanced issues, two large and similarly rated un-enhanced issues were sold by IDEA Public Schools (S&P "BBB" - 2009) and Uplift Education (S&P "BBB-" - 2010).
- We analyzed the results of each pricing and found that the partial enhancement resulted in negligible, <u>if any</u>, reduction in the cost of capital for the two enhanced issues versus the un-enhanced issues as measured by the spread to the MMD.

Example MMD Matrix – All Bond Issues are Priced as a “Spread” to the High-grade (AAA)

Municipal Yield Curves as of 03/30/2010

		General Obligations					
		"AAA"	PRE-RE	INSURED	"AA"	"A"	"BAA"
1	2011	0.32	0.34	0.56	0.39	0.74	2.04
2	2012	0.79	0.83	1.13	0.91	1.31	2.71
3	2013	1.10	1.14	1.53	1.25	1.71	3.05
4	2014	1.45	1.49	1.94	1.61	2.07	3.43
5	2015	1.77	1.81	2.32	1.94	2.42	3.76
6	2016	2.21	2.25	2.77	2.38	2.87	4.20
7	2017	2.52	2.56	3.09	2.69	3.20	4.52
8	2018	2.74	2.78	3.32	2.91	3.46	4.75
9	2019	2.94		3.53	3.12	3.67	4.94
10	2020	3.08		3.67	3.26	3.83	5.05
11	2021	3.18		3.81	3.37	3.97	5.14
12	2022	3.26		3.89	3.46	4.06	5.20
13	2023	3.34		3.97	3.54	4.14	5.24
14	2024	3.42		4.03	3.62	4.22	5.29
15	2025	3.50		4.09	3.70	4.30	5.34
16	2026	3.58		4.15	3.78	4.38	5.38
17	2027	3.66		4.22	3.85	4.44	5.41
18	2028	3.73		4.27	3.91	4.49	5.44
19	2029	3.80		4.32	3.98	4.54	5.46
20	2030	3.86		4.36	4.04	4.58	5.48
21	2031	3.92		4.41	4.09	4.62	5.49
22	2032	3.97		4.45	4.14	4.65	5.50
23	2033	4.01		4.49	4.18	4.67	5.51
24	2034	4.05		4.52	4.22	4.69	5.53
25	2035	4.09		4.55	4.26	4.71	5.55
26	2036	4.12		4.57	4.29	4.73	5.56
27	2037	4.14		4.58	4.30	4.74	5.57
28	2038	4.15		4.59	4.31	4.75	5.58
29	2039	4.16		4.60	4.32	4.76	5.59
30	2040	4.17		4.61	4.33	4.77	5.60

Last Update: Tue Mar 30 15:20:53 EDT 2010

High-Grade (AAA) MMD Spread Comps

KIPP Houston - $66 Million			IDEA Public Schools - $29 Million – 8 Investors	
Priced October28,2009			Priced November 19, 2009	
			2013	+218
2014	+226		**2014**	+219
2015	+230		**2015**	+220
2016	+229		**2016**	+222
2017	+228		**2017**	+228
2018	+220			
2019	+216			
2024	+240		**2024**	+237
2029	+228		**2029**	+250
2039	+212		**2039**	+222
2044	+222			
TIC	+222		**TIC**	+213

High-Grade (AAA) MMD Spread Comps

Aspire Public Schools - $90 Million – 14 Investors			Uplift Education - $57 Million – 13 Investors	
Priced March 25, 2010			Priced March 30, 2010	
			2012	+211
			2013	+210
			2015	+223
			2016	+209
2020	+195/+215			
			2025	+228
2030	+216		**2030**	+229
2040	+208		**2040**	+211
2045	+218		**2045**	+223
TIC	+216		**TIC**	+219

Reducing Cost of Capital – $20MM Project

- <u>TEBs Alone</u>
- 37-year financing
- Par:
  - $22,360,000
- Annual D/S:
  - Year 1-37: $1,610,039
  - Total: $57,961,418
- Interest Rate: 6.50%
- IRR: 6.44%

- <u>NMTC/TEB Combo</u>
- 37-year financing
- Par:
  - Lev. Loan: $16,875,000
  - Sub-Debt : $ 6,000,000
- Annual D/S
  - Year 1-7: $1,234,063
  - Year 8-37: $1,309,033
  - Total: $46,601,392
- Interest Rate: 6.75% (LL)
- IRR: 4.44%

Reducing Cost of Capital – $20MM Project

- TEBs alone require $375K more in annual debt service during 7-year compliance period than combo structure
- TEBs alone require $300K more in annual debt service for the 30-year post-compliance period than combo structure
- A $20MM project typically could house 1,000 students ($20K per student capital cost), meaning the combo structure would result in:
  - $375 per student lower facility cost during compliance period
  - $300 per student lower facility cost for 30-year post-compliance period
- Reduced facility cost has same effect on budget as an increase in operational funding but WITHOUT ANY BURDEN ON STATE

Credit Enhancement Facility (CEF)

- $6.170 Million Credit Enhancement Facility (CEF) for a $20 Million project
- Declines annually as payments are made.

		Re-deployed Enhancement
– Payments Yr 1	$1,234,063	
– CEF End of Year 1	$ 4,936,250	$1,234,063
– Payments Yr 2	$ 1,234,063	
– CEF End of Year 2	3,702,188	$2,468,125
– Payments Yr 3	$ 1,234,063	
– CEF End of Year 3	$ 2,468,125	$3,702,188
– Payments Yr 4	$ 1,234,063	
– CEF End of Year 4	$ 1,234,063	$4,936,250
– Payments Yr 5	$ 1,234,063	
– CEF End of Year 5	$0	$6,170,313

Comparison w/ TEBs

- TEBs Alone
  - 100% Enhancement tied up for 10 years
  - Leverage ratios have been about 3:1 – 5:1
  - Negligible, if any, reduction in school's cost of capital
    - Proven by comps w/ IDEA and Uplift

- NMTC/TEB Combo
  - Enhancement burns off annually – average life 2.5 years (75% less than TEBs alone)
  - Leverage ratio approximately 4:1
  - Schools receive 200 basis point (31%) reduction in cost of capital

Conclusions

- Reducing the cost of capital for charter school facility financings will lower annual debt service costs for charters, achieving the same result as grant funding or increases in operational funding (i.e. more $$ in the classroom). Recent efforts to achieve a reduction in capital costs have centered on enhancing TEBs vs. structures such as NMTCs and Stimulus/HIRE programs, or combos structures.

- Based upon the KIPP and Aspire deals versus IDEA and Uplift, respectively, <u>partially</u> enhancing TEBs neither reduces the cost of capital nor results in increases in sources of financing.

- NMTCs, structures arising from Stimulus Plan/HIRE Act, and combo structures such as NMTC & TEBs will help achieve the goal of reducing charter schools' cost of capital, ***<u>but these markets need partial enhancement to attract investment</u>***.

- Enhancement is needed for these structures because most loans and investments arising from NMTC and Stimulus/HIRE are taxable, and there are not nearly the broad and deep taxable lending sources for charters as exists in the tax-exempt market, or to address other factors.

- Any entity that wishes to enhance charter financings should seriously consider a partial enhancement program to include NMTC, combo and other structures in order to help achieve the goal of reducing charter schools' cost of capital and debt service, because <u>those markets need the enhancement to attract the necessary capital</u> while the tax-exempt market does not need nor value partial enhancement.