District of Columbia
Office of the State Superintendent of Education

DIRECT LOAN AND CREDIT ENHANCEMENT PROGRAMS POLICY AND GUIDANCE

Office of Public Charter School Financing and Support

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DISTRICT OF COLUMBIA
OFFICE OF THE STATE SUPERINTENDENT OF
EDUCATION

Background

The Office of Public Charter School Financing and Support (OPCSFS) within the District of Columbia Office of the State Superintendent of Education (OSSE) oversees and administers the Direct Loan and Credit Enhancement Programs and corresponding revolving funds.

Direct Loan Fund

The **Direct Loan Fund for Charter School Improvement** ("Direct Loan Fund") was created initially by the District of Columbia Appropriations Act, 2003 (D.C. Code § 38-1833.02(a); Pub.1.No.108-7, Section 143(b)). The goal of the Direct Loan Fund is to structure and provide loans to District of Columbia public charter schools for the purpose of construction, purchase, renovation and maintenance of public charter school facilities. Additional capital allocations were appropriated to the Direct Loan Fund and the Credit Enhancement Revolving Fund during fiscal years 2001-2011 (FY01-FY11). In FY13 and FY14, the Direct Loan Fund was also awarded additional funds under the federal Scholarships for Opportunity and Results (SOAR) Act.

Credit Enhancement Revolving Fund

The **Credit Enhancement Revolving Fund** ("Credit Enhancement Fund") was authorized by Section 603 (e) (3) (C) (iii) of the Student Loan Marketing Association Reorganization Act of 1996 (20 U.S.C. 1155(e) (2) (B) and approved in accordance with DC Official Code §2-301.05a (Supp. 2007). A credit enhancement issued through the Credit Enhancement Fund provides unfunded enhanced credit and lease and loan guarantees for the construction, purchase, renovation and maintenance of public charter school facilities. For example, in situations where the appraised value of the property does not meet a lender's loan-to-value requirement, a credit enhancement may be used to bridge the shortfall. Credit enhancements may be offered alone or in conjunction with a direct loan.

Eligibility

Eligible Borrowers[1]

Eligible borrowers must be:

- Public charter schools located in the District of Columbia with a charter in effect pursuant to the District of Columbia School Reform Act of 1995, and which meet or exceed the performance goals as outlined in the current charter;
- A limited liability company that participates in a New Markets Tax Credit program transaction structure with public charter schools;
- Nonprofit organizations that are engaged in the promotion of credit enhancement initiatives for the development of charter school facilities, or
- Nonprofit organizations authorized by a public charter school to act on their behalf in obtaining financing to cover an eligible project; and
- Nonprofit organizations that develop and finance a facility that will be occupied by a public charter school throughout the term of the loan.

Eligible Projects[2]

Financing is available for proposals to:

- Obtain and/or acquire real property (by purchase, lease or donation), including financing to cover planning, development and other incidental hard and soft costs;
- Obtain financing for construction of facilities or the renovation, repair, or alteration of existing property or facilities including planning, development and other hard and soft incidental costs; or
- Obtain loans and/or bond financing that requires a credit enhancement guarantee (i.e., any loan where the issuer is requesting additional collateral or support).

Note: Funds provided under a grant from the Credit Enhancement Fund may not be used by a recipient to make direct loans or grants to public charter schools. 20 U.S.C. § 1155(e)(3)(E)(ii).

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[1] The Direct Loan Fund eligibility criteria for loans is outlined at D.C. Code § 38–1833.02(f)(A)-(C).
[2] The Credit Enhancement Fund criteria for eligible borrowers is outlined at 20 U.S.C. § 1155(e)(3)(E).

Standard Terms and Conditions

Below are some of the standard terms and conditions for Direct Loans and Credit Enhancements from OPCSFS, which may vary depending on the nature of the transaction and project. Alternate terms and conditions may be considered by the Public Charter School Credit Enhancement Committee (established by Mayor's Order 2016-037) during the underwriting, application review and approval process, or by OPCSFS during the loan closing process.

Direct Loans

- Maximum loan size: $2 million
    - A project may have up to a $2 million direct loan and a $1 million credit enhancement for a maximum total of $3 million in financing from OPCSFS
- Term: one to five years for direct loan; seven-year term for a direct loan that is part of a New Markets Tax Credit transaction[3]
- Fixed interest rate: 1 percent as of 2020
- Interest only period during construction or the first two years following the date of loan closing
- Principal payments based on a fully-amortizing, 15- or 25-year schedule (or other terms as negotiated) with a balloon payment at maturity
    - Loans may be refinanced, modified and/or extended with the approval of the Public Charter School Credit Enhancement Committee
- Quarterly payments based on a traditional mortgage loan structure; as such, payment amounts remain the same each quarter
- The borrower may, at any time, during the term of the direct loan, repay the loan in part, or in full, without any prepayment penalty
- Closing fee of 1 percent of the loan amount (i.e., $20,000 for a $2 million direct loan)
- The borrower must pay for their own legal counsel services, as well as all related closing costs and fees
- OPCSFS will seek to collateralize and secure all of its loans with a senior or subordinated lien on the real estate, depending on the financial metrics of the transaction. In situations where there are multiple subordinate lenders, OPCSFS will seek to participate and secure its lien on a *pari passu* basis with other similarly structured subordinated lenders. OPCSFS generally will also take a lien on the uniform per pupil funding and facilities allowances. In the case of a senior lender, OPCSFS will take a subordinate lien.
- The borrower shall contribute at least 5 percent of the total project cost in equity. Grants awarded to the borrower may serve as project equity.

[3] Note: the authority for the loan term length periods is codified at D.C. Code § 38–1833.02(h).

Credit Enhancements

- Maximum credit enhancement: $1 million
    - A project may have up to a $2 million direct loan and a $1 million credit enhancement for a maximum total of $3 million in financing from OPCSFS
- Up to a five-year term, with the exception of a New Markets Tax Credit transaction
- Fee of 1 percent due annually on the anniversary of the closing date
- As the loan balance secured by the credit enhancement reduces through repayment, the credit enhancement amount will reduce on a pro-rata basis
- All credit enhancements will be unfunded (unfunded credit enhancement funds are held by the guarantor (OPCSFS) and provided to the beneficiary in the event of default)
- The borrower must pay for their own legal services but will not be charged a fee for OPCSFS' legal services

Loan and Credit Enhancement Underwriting and Review Process

OPCSFS performs a financial analysis for each prospective project to efficiently and responsibly deploy capital to promote the growth of high-performing public charter schools which is then presented to the Public Charter School Credit Enhancement Committee ("Credit Enhancement Committee"), an independent loan committee established by Mayor's Order 2016-037, for review and approval or denial. The Credit Enhancement Committee is composed of five members; three of whom are appointed by the Mayor of the District of Columbia and two of whom are appointed by the DC Public Charter School Board (PCSB). A public charter school or nonprofit organization must submit a completed application and all required supporting documentation to OPCSFS for underwriting.

Timeline

The Credit Enhancement Committee meets on the third Thursday of every month (or at duly-constituted special meetings) to approve or deny direct loan or credit enhancement requests. Meetings dates for the year are posted on the Office of Open Government Open Meetings Calendar and in the DC Register. The meetings are open to the public and the agenda and minutes from each meeting are posted on the OSSE website.

A completed Application for Direct Loan or Credit Enhancement **and all required documents are due no later than the third Friday of the month to be eligible for presentation at the following month's Credit Enhancement Committee meeting.** In addition to the application form itself, applicants must also submit all supplemental documents for an application to be considered complete. A list of these documents is detailed below. Please note, if more than two applications are received in a particular month, only the first two complete applications received by OPCSFS will be reviewed at the following month's committee meeting.

Initiating a Request for Financing

To initiate a financing request, contact Darryl Brantley, OPCSFS Financial Program Specialist, at (202) 258-3541 or Darryl.Brantley@dc.gov. If the request meets the eligibility requirements for a direct loan and/or credit enhancement, an applicant will be instructed to complete the Application for a Direct Loan or Credit Enhancement and submit the required documents for underwriting as outlined in the application.

Required Supplemental Documents

For an application to be considered complete, the following supplemental information and documents must be submitted:

General Information

- ☐ 1.1 Borrower Articles of Incorporation
- ☐ 1.2 Borrower Bylaws
- ☐ 1.3 Borrower Conflict of Interest Policy
- ☐ 1.4 501(c)3 status letter
- ☐ 1.5 Board Resolution/Minutes Evidencing Borrower's Intent (signed by board chair)
- ☐ 1.6 Local education agency (LEA) PCSB Application
- ☐ 1.7 LEA Charter Agreement
- ☐ 1.8 Borrower and LEA Senior Management Bios (not resumes)
- ☐ 1.9 Borrower and LEA Board of Director Bios (not resumes)
- ☐ 1.10 Detailed Background and History of the LEA and Charter Management Organization (CMO), if applicable
- ☐ 1.11 Detailed Description of Education Programs
- ☐ 1.12 Marketing Plan and Demographic Targets
- ☐ 1.13 Neighborhood Information and Demographics

Financial Information

- ☐ 2.1 Audited Financial Statements for last three years
- ☐ 2.2 Last three months' bank statements evidencing cash on hand
- ☐ 2.3 Sources and Uses of Funds
- ☐ 2.4 Five-year enrollment forecast by grade
- ☐ 2.5 Five-year annual budget projections (i.e., balance sheet, income statement)
- ☐ 2.6 Written commentary addressing the following:
  - Borrower plan to take out the OPCSFS loan balloon payment

- All assumptions including material year-to-year variances on the income, cash flow, and balance sheet statements
    - Any significant after-school programs, including the historical management/success of the program
    - Reliance on future grants
- ☐ 2.7 Executed Copies of Commitment Letters from Senior Lender and other financing providers, as applicable

Project Information

- ☐ 3.1 Evidence of Site Control (e.g., Purchase Agreement, Option Agreement, Leader and/or Sublease agreement, Memorandum of Understanding)
- ☐ 3.2 Bank-ordered Appraisal of Property
- ☐ 3.3 Environmental Phase I
- ☐ 3.4 Engineering Report/Property Needs Assessment, if applicable
- ☐ 3.5 Business Plan and Project Description, including:
    - Detailed project description and justification
    - Project Budget, including predevelopment costs
- ☐ 3.6 Project Timeline, including:
    - Target Financing Closing
    - Anticipated Construction Begin and End
    - Anticipated Opening/Begin Operations

OPCSFS Underwriting and Review of the Application

OPCSFS' review follows underwriting best practices and takes into consideration the following factors when evaluating an application for a direct loan and/or credit enhancement:

A. New Additions to the LEA, including:

- Number of new students;
- Number of new classrooms;
- Additional grades to be served:
- Additional classroom square footage; and
- Additional total square footage.

B. Terms and Conditions of other lenders, including:

- Amount of the loan;
- Interest rate, amortization term, fees;
- Collateral; and

- Loan covenants (debt service coverage; cash requirements; financial reporting requirements).

C. Debt Repayment

- Is operating cash flow sufficient to make the required debt payments over the term of the loan?
- Is obtaining long-term financing in the form of new debt, New Market Tax Credits, or tax-exempt bonds feasible for this project. If not, can the project's cash flow support a fully amortizing loan?
- Does the appraisal indicate sufficient collateral value to repay the OPCSFS loan should the school decide to cease operations and sell the building?

D. Risks and Mitigants

During the underwriting process, OPCSFS will identify the risks associated with the project and will review the borrower's application for clear identification of risks and for a plan of how these risks would be mitigated (e.g., capacity of project management team, waitlist data and cash position).

E. Project Analysis

- Is the project timeline realistic? Does the project timeline result in the school opening as planned?
- What is the scope of the renovations? What infrastructure changes are needed (windows, HVAC, flooring, etc.)? The development budget must be reasonable and the cost per square foot realistic and reasonable for similar projects.
- Does the site (acreage, Metro accessibility, roads and ease of entry to and from the property) support the project?
- Does the neighborhood support the project? What other schools are in the area? Is it a residential or commercial area?
- Are the lease terms (term of lease, rent abatement for renovation spending, renewal terms) favorable?
- Are the sources of construction funds for the project sufficient to meet uses? The school's equity contribution is included in the fund sources.
- What is the project team's level of experience with charter school development?

F. Public Charter School Charter

OPCSFS will review the school's charter issued by PCSB and will note the total length of and the remaining years on the charter. Correspondence between the Borrower and PCSB will be read and any corrective actions noted.

G. Enrollment and Market Analysis

OPCSFS will conduct a market analysis by reviewing the following:

- Enrollment to include actual and projected enrollment, historical enrollment, retention rates and waitlist data;
- The written marketing plan and whether the school has dedicated staff for the marketing function, and if so, whether the staff has prior marketing experience;
- If the market will support the proposed project;
- If the school will meet its enrollment targets;
- The school's proximity to other public charter schools and traditional schools and whether the school's program is unique for this market.

H. LEA Management

- The board of directors including the size, composition, and individual expertise;
- The school leadership including the number of leadership positions, background and experience, track record, length of tenure and long-term commitment at the current school;
- If a CMO or Education Management Organization (EMO) is involved, the track record of the CMO or EMO, number of schools managed and organizational reputation; and
- The role of the CMO or EMO including the level of involvement, functions and responsibilities.

I. Academic Performance and Curriculum

OPCSFS will review the following regarding the academic performance and curriculum of the school:

- PCSB's Performance Management Framework Reports; and
- A description of the curriculum to identify any uniqueness or competitive advantages.

J. Financial Statement Analysis

The borrower will submit three years of historical information, if applicable, and a five-year financial forecast. OPCSFS will analyze the strength of the balance sheet, cash position, existing liabilities and will review the audited financial statements. In addition, OPCSFS will:

- Analyze the operating cash flow to measure its sufficiency in meeting its debt service obligations;
- Review the revenue sources, timing, amounts, predictability and the impact on cash flow given a reduction in revenue;
- Review the expense projections and compare to industry benchmarks to determine if the expenses are realistic;
- Measure compliance to any financial covenants (debt service coverage, liquidity ratios, etc.);
- Analyze year-to-date actual financial results versus budget; and

- Review any third-party fees to ensure they are reasonable and present no undue burdens on the school.

K. Direct Loan and Credit Enhancement Fund Performance Ratios

The following performance ratios will be applied to all projects not only as a basis for determining the borrower's ability to repay the debt, but also as the basis for establishing OPCSFS' covenants that will be set forth in the financing documents and that will be used to monitor the borrower's future financial performance:

- Preferred total minimum debt service coverage ratio of 1.15x at project stabilization preferred;
- For transactions with less than a 1.15x debt service coverage ratio, a debt service reserve may be required;
- Minimum current ratio of 1:25:1.0;
- Facilities coverage ratio (total facilities allowance divided by total facility related costs) in excess of 1.1.x. Higher facilities coverage ratios are preferable;
- Preferred loan to value of 95 percent; and
- Maximum percentage of project cost:
    a. If OPCSFS is the sole lender, OPCSFS will finance up to 80 percent of the project costs (not to exceed $2 million): borrower equity is required for the remaining 20 percent.
    b. If OPCSFS' debt is supporting senior financing, OPCSFS can loan up to 25 percent of project costs (not to exceed $2 million).

For new or recently opened public charter schools that have not yet achieved full enrollment, these performance ratios should realistically be achieved once full enrollment is reached. However, in no event should the projected debt service coverage be below 1.0x.

OPCSFS recognizes that school buildings may have limited collateral value, particularly improvements to leased facilities. In cases where there is no collateral value available to secure the OPCSFS loan, OPCSFS will look for high debt service coverage ratio.

L. Past OPCSFS Direct Loan, Credit Enhancement, and Grant Performance

Payment history and timely submission of financial reports on previous direct loans and credit enhancements are two significant factors considered when OPCSFS evaluates a request for a direct loan and/or credit enhancement. Additionally, the borrower's performance on any grants awarded by OSSE is factored into the decision to approve or disapprove a direct loan and/or credit enhancement.

Credit Enhancement Committee Review of the Application

OPCSFS staff prepares a credit memorandum and provides it to the membership of the Credit Enhancement Committee in advance of the meeting. The credit memorandum provides the members with the underwriting of the direct loan and/or credit enhancement request including information necessary to assess the benefits and risks of the transaction. Applicants are invited and strongly encouraged to attend the public meeting. In cases where there are specific questions about the request, the applicant may be required to attend.

Applicants will be notified of the decision by the Credit Enhancement Committee to approve or deny the request. If the request is approved, the applicant is sent a commitment letter within 30 days outlining the terms for acceptance by the public charter school. Once the public charter school has accepted the terms, the loan closing process will begin.

OPCSFS Loan Servicing

Within 30 days of loan closing, the borrower is sent a welcome letter that includes its loan amortization schedule, listing payment due dates and the total payment amount due in principal and interest. For credit enhancements, a schedule is sent showing the due dates for the annual service fee. The welcome letter also outlines payment options for the borrower including wire transfer instructions (preferred method) and physical check mailing instructions.

Invoices are sent to all borrowers at least 30 days before a payment is due. Payments are required to be made when due. Delinquencies will be monitored, and past due balances will be reflected on future invoices. Payment history and delinquencies are included in the credit memorandum for any future direct loan or credit enhancement requests from the borrower.

Borrowers are also subject to financial reporting requirements that are outlined in the loan documents. Annual audited financial statements, quarterly unaudited financial statements, budgets and other project related information are required to be submitted as outlined in the loan agreement. Timeliness of reporting will be monitored and a pattern of late reporting may adversely impact a school’s ability to be approved for future financing from OPCSFS.