M E M O R A N D U M **Staff Summary No. 5**

Date: May 25, 2022

To: Members of the California School Finance Authority (CSFA)

From: Katrina M. Johantgen, Executive Director

Subject: Resolution No. 22-28 – Approving Bond Financing in a Not-to-Exceed Amount of $28,000,000 for River Springs Charter School, Located in Riverside County

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Financing Approval Background: At its February 24, 2022 board meeting, the California School Finance Authority (CSFA) approved a financing in a not-to-exceed amount of $48,000,000 for River Springs Charter School (RSCS). The financing included both new money (tax-exempt) and refunding (taxable) components. As the refinancing portion is being refinanced prior to the earliest call-date on the outstanding bonds, the refinanced debt must be issued on a taxable basis.

The RSCS item was brought to the Board prior to the conflict in the Ukraine, the consequent upheaval of the financial markets, and skyrocketing interest rates, which has had a negative impact on municipal debt in general as well as below investment grade municipal debt such as the RSCS bonds. The new money (tax-exempt and taxable) portion of the financing was for deadline-driven facility acquisition and was met with interest in the market. However, the taxable portion of the financing was not sold. As such, RSCS decided to bifurcate the issuance, pricing and closing $10,845,000 in bonds ($470,000, taxable, and $10,375,000, tax-exempt) in early April, but deferring the taxable refunding component, in hopes of capitalizing on better market conditions.

Financing Update: Without market interest in the taxable bonds for the refunding portion, and to keep the refunding viable for the school, the underwriter sought out and was able to find an investor willing to purchase bonds that are referred to as "Cinderella" bonds. In a Cinderella bond issuance, the bonds are sold at taxable interest rates for a period until the call date of the bonds to be refunded, and then convert to tax-exempt interest rates, hence the term Cinderella. The borrower can lock in long-term tax-exempt interest rates now, while complying with federal tax laws, by paying higher interest rates upfront. The underwriter conveyed that this structure has been around for years but is not used very frequently, as there isn't a ready buyer base for the structure. Additionally, although the period of time that Cinderella bonds are taxable is typically less than one year, the proposed RSCS Cinderella bonds will have a taxable period of more than three years.

Hamlin Capital Management (Hamlin) is an investment advisor that manages over $4 billion for high-net-worth individuals and institutions and is interested in purchasing the RSCS bonds. Hamlin provided RSCS with a proposed term sheet that meet their economic targets with the following terms:

1) The first optional call date will depend on the conversion date.
2) Following the conversion of the bonds to tax-exempt, if the bonds are ever determined to be taxable, a 1.37x interest rate penalty will apply, and the bonds will be subject to mandatory redemption in full within 180 days.
3) In addition, a general default rate of +3% will apply.
4) A modification to CSFA's sales restrictions and debt issuance guidelines.

CSFA has specific sales restrictions that correlate to the varying credit qualities of each bond issuance. In the case of unrated transactions, the sales restrictions tend to be the most stringent to protect less sophisticated investors. As part of those restrictions an investor must comply with the following:

- Bonds will be in minimum denominations of $100,000;
- Bonds will be privately placed or publicly offered initially to Qualified Institutional Buyers and Accredited Investors;
- Initial bond purchasers will be required to execute an Investor Letter;
- Subsequent transfers of bonds will be limited to QIBs and Ais;
- Sales restrictions conspicuously noted on bond and described in detail in offering materials, if any, as well as in the bond documents;
- One or more of the following will be required depending on the transaction, as requested by the financing team and approved by the Authority:
    a. Traveling Investor Letter; or
    b. Higher minimum denominations of $250,000; or
    c. Physical Delivery; or
    d. Limited initial sale to QIBs, with subsequent transfers limited to QIBs as well; or
    e. <u>Other investor protection measures</u>
- Bond payments will be made via the intercept mechanism outlined in Section 17199.4 of the Education Cod

Hamlin will comply with the restrictions on the bonds, and has chosen e. *Other Investor protection measures*, under the sixth bullet point and menu of options. Hamlin has proposed that, while the bonds are within the Hamlin system, the bonds would be placed in minimum denominations of $100,000 to its investors that do not all meet the criteria to be deemed QIB's. If for some reason any amount of the bonds were to leave the Hamlin system, the trustee would be required to increase the minimum denomination of those bonds to $250,000.

As such, per Hamlin's request and after conversation with our Public Finance Department and counsel, Hamlin will be meeting requirement *e.* by virtue of their own internal investor protections. *Final decision on use of e. is not currently covered in the Board's Delegation Resolution to the Executive Director, as such, the Board needs to approve that decision as well.*

The bonds will require a new indenture, loan agreement, and bond purchase agreement, which are similar to those the Board approved in February, except that they provide for the conversion described above and the different terms under Hamlin's term sheet. The Borrower will be able to elect to cause the conversion to the specified tax-exempt rates and the conversion will require a process that will include a requirement for the majority bondholder to choose from two or more redemption provisions that will be applicable following the conversion.

The conversion will also require (i) a notice, hearing and approval under the Tax Equity and Fiscal Responsibility Act (TEFRA), (ii) a tax certificate executed by the Authority, River Springs Facilities II LLC (Borrower), and RSCS, as the lessee, (iii) replacement bond forms prepared, executed, and authenticated by the Trustee, and (iv) delivery of a new opinion of bond counsel regarding the bonds to be effective at the date of conversion.

<u>Additionally, due to the added complexity of the Cinderella structure, the underwriter's discount on the Series C bonds increased from $20/$1,000 in bonds to $25/$1,000 in bonds.</u>

Accordingly, the updated Sources and cost of issuance have been updated below.

River Springs 2022CD - Estimate Sources & Uses As of 5/24/2022				
	Series 2022C (Cinderella)	Series 2022D (Taxable)	CSFA Credit Enhancement	Total
Bond Amount	$ 24,530,000	$ 720,000	$ -	**$ 25,250,000**
2015 Revenue Fund	780,431	-	-	**780,431**
7/1/2022 Payment (2015 Bonds)	1,170,878	-	-	**1,170,878**
2015 Reserve Fund	2,121,968	-	-	**2,121,968**
2015 R&R Fund	206,050	-	-	**206,050**
2015 Other Fund Balances	42,487	-	-	**42,487**
CSFA Credit Enhancement	-	-	2,000,000	**2,000,000**
Total Sources	**$ 28,851,814**	**$ 720,000**	**$ 2,000,000**	**$ 31,571,814**
	Series 2022C (Cinderella)	Series 2022D (Taxable)	CSFA Credit Enhancement	Total
2015 Refunding Amount	$ 28,157,930	$ -	$ -	**$ 28,157,930**
Debt Service Reserve Fund	-	-	2,000,000	**2,000,000**
Repair & Replacement Fund	206,050	-	-	**206,050**
Cost of Issuance	485,601	719,563	-	**1,205,164**
Additonal Proceeds	2,233	438		**2,670**
Total Uses	**$ 28,851,814**	**$ 720,000**	**$ 2,000,000**	**$ 31,569,143**

Cost of Issuance:	Budgeted Amount
Issuer Fee	$22,625.00
Issuer 1st Admin Fee	$3,787.50
Issuer Application Fee	$1,500.00
Agent-for-Sale Fee	$6,000.00
Issuer's Counsel Fee (AG's Office)	$8,000.00
Financial Advisor Fee	$60,000.00
Bond Counsel Fee	$120,000.00
Investor Counsel Fee	$40,000.00
Underwriter's Counsel Fee	$60,000.00
Borrower's Counsel Fee	$60,000.00
Trustee Fee	$6,000.00
Trustee's Counsel Fee	$4,000.00
Ratings Agency - Moody's	$0.00
Ratings Agency - Fitch	$0.00
Rating Agency - S&P	$50,000.00
Financial Printer Fee	$5,000.00
CDLAC Fee**	$2,000.00
Miscellaneous COI *(specify)*	
Title Fees & Charges, Endorsements	$100,000.00
Contingency	$25,000.00
Total COI	**$573,912.50**

Recommendation: Staff recommends the Board adopt Resolution No. 22-28, approving bond issuance in a not-to-exceed amount of $28,000,000 to refinance the acquisition, construction, expansion, rehabilitation, renovation, furnishing and equipping of educational facilities located in Riverside County, California for use by River Springs Charter School, as well as related bond documents and use of *other investor protection measures* in meeting CSFA's sales restriction requirements.