WyeRiver
INDEPENDENT FINANCIAL ADVISORS

Dollars & Sense

Developing an Integrated Plan for Fundraising and Debt Financing

522 Chesapeake Avenue
2nd Floor
Annapolis, MD 21403
P 410.267.8811

1629 K Street N.W.
Suite 300
Washington, DC 20036
P 202.810.1703

285 West Broadway
Suite 200
New York, NY 10013
P 212.203.4179

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INTRODUCTION

- **An Independent School's two favorite flavors of money**
  - FREE…… Charitable Donations and Grants, and
  - CHEAP…… Tax Exempt Financing
- **Sometimes, the amount of free money is not adequate for a Project or other needs of the School**
  - Project cost is higher than fundraising capacity or receipts,
  - Timing of pledge receipts is too long relative to preferred Project development timetable, or
  - School needs fundraising proceeds for other priorities (programs, working capital, satisfaction of debt financing requirements)
- **Thus, borrowing becomes a necessary alternative and tax-exempt financing is usually the cheapest form of borrowing for Independent Schools**
- **An integrated and well-coordinated fundraising and tax-exempt financing effort can produce remarkably low cost outcomes. An uncoordinated effort, on the other hand, can produce sub-optimal, and in some cases disastrous, results**

WHY FINANCE TAX-EXEMPT?

- **For projects of appropriate size and complexity, tax-exempt financing will produce the overall lowest cost of borrowed capital**
  - acquisition of land or a new facility
  - construction or rehabilitation of a facility
  - certain longer-life equipment purchases
  - improvements to leased property
  - reserves, interest cost and transaction costs
- **As a general rule, tax-exempt financing is best for**
  - capital assets
  - Project costs more than $5 million
- **Other needs may be ineligible or less appropriate for tax-exempt financing**
  - Project costs less than $5 million
  - working capital
  - primarily unrelated business income-producing facilities

CRUCIAL ADVANCE PLANNING ACTION ITEMS

- **Reimbursement Resolution – in order to be reimbursed from tax-exempt proceeds for earlier cash advances**
- **Line of Credit – an alternative to equity for funding early Project development costs until debt financing closes**
- **Key Fundraising Plan Issues**
  – "replacement proceeds"
  – fundraising communications
  – naming opportunities and rights
  – integration of fundraising projections into finance plan

DEALING WITH A RESTRICTED GIFT

- **How a Restriction Arises**
  - Based on tax definition, not GAAP definition: Use of funds is restricted to the Project
  - *Explicit*: Donor intent or explicit requirement
  - *Implicit*: Through solicitation materials
  - *By Action*: Depositing gift in "Building Fund"
- **Naming Rights**
  - Condition of donor, or tied to Project: *Restricted*
  - Expression of gratitude of recipient: *Unrestricted*
- **If Gift is Restricted**
  - Reimburse School for Project-related advances
  - Apply to Project improvements (change orders)
  - Apply to debt repayment
  - Approach donor to request change in restriction

EFFECTIVE FUNDRAISING COMMUNICATIONS

- **First, the "DON'TS"**
  - Don't limit the fundraising request to just the Project being financed
  - Don't use the term "Capital Campaign" unless you identify a broad range of intended uses and there is no inference that a specific portion will be used for the Project
  - If an array of proposed uses are described in the solicitation, don't ascribe specific dollar amounts to each such use
  - Don't use the term "Endowment" unless you specifically intend that the gift corpus will be preserved. (If that is the intent, seek to secure flexibility in the use of the earnings on such funds)
  - Don't attribute gifts to the Project or specific elements of the Project (or provide the opportunity to do so in the donor pledge card)

EFFECTIVE FUNDRAISING COMMUNICATIONS

- **And now, the "DO'S"**
  - In contrast to not using the term "Capital Campaign", the use of the terms "Campaign" or "Development Campaign" in communication is fine *(How is that for splitting hairs?)*
  - Further, discussing various and diverse proposed uses of the fundraising proceeds (preferably for operations and facilities) is also fine
  - And, as a prelude to such a discussion, it would be beneficial to describe the School's broad mission goals
  - Although not absolutely necessary, specific statements in the solicitation materials are a good way to remove any doubt. For instance
    - "the donations will be treated as 'unrestricted' unless otherwise indicated" or
    - "proceeds of fundraising will be used as directed by the School's Board of Trustees for a variety of purposes"

INTEGRATING FINANCE & FUNDRAISING PLANS

- **What is the School's desired end result financially?**
  - Viable/affordable debt financing
  - Optimal use of gift and debt capital
  - Successful Project
- **Key financial metrics for determining optimal outcome**
  - Liquidity
  - Debt service coverage
  - Balance sheet leverage
  - Endowment investment enhancement

CASE STUDY #1 – WELL CAPITALIZED

SCHOOL PROFILE

- Well capitalized / strong endowment
- Full enrollment / no programmed growth
- Primarily affluent market
- Significant equity and debt capacity

SCENARIO

- $20 million of outstanding debt
- $20 million Project
- $50 million permanent debt capacity
- $20 million Capital Campaign – Silent Phase / Flexible Donor Base

SOLUTION

- $40 million fixed rate bond issue
  - $20 million refunding
  - $20 million new money
  - Cost of capital: 3.0%
- Capital Campaign receipts to endowment
  - Targeted Return: 6.0%
  - Annual Draw: 4.0%
- *Rationale*: More highly leveraged, but greater balance sheet flexibility and endowment growth opportunity

CASE STUDY #2 – MODESTLY CAPITALIZED

SCHOOL PROFILE

- Modestly capitalized
- No capacity for equity investment in Project
- Full enrollment / no room for growth
- Primarily middle income market
- Limited growth in projected net operating income
- No outstanding debt

SCENARIO

- $18 million Project
- $12 million permanent debt capacity
- $7.5 million Capital Campaign
  - Fully pledged but with receipts over the next 5 years
  - Mostly restricted gifts

SOLUTION

- Series A Bonds
  - $12 million
  - Fixed rate
  - DSC & liquidity covenants
  - Mortgage and revenue pledge
- Series B Bonds
  - $6 million
  - Variable rate (drawdown structure)
  - Pledge of Capital Campaign receipts
  - No financial covenants

- Capital Campaign receipts used to repay Series B Bonds
- At end of 5 years, net "permanent debt" of $12 million
- *Rationale*: Debt financing required initially for all Project costs, but with a structure which programs deleveraging with Campaign proceeds ultimately to a sustainable level of permanent debt capacity

CASE STUDY #3 – UNDERCAPITALIZED

SCHOOL PROFILE

- Undercapitalized
- Growing enrollment / facility constrained
- Middle income market
- No equity investment capacity

SCENARIO

- $15 million Project
- $15 million permanent debt capacity
- $5 million Capital Campaign

SOLUTION

- $15 million fixed rate issue
- Capital Campaign receipts to Working Capital
- *Rationale*: A highly leveraged result, but adequate liquidity is a priority in support of operations and feasible debt financing over the long term

SUMMARY

- **Fundraising is always challenging**
- **Tax-exempt financing can be complex, but used optimally can close a Project cost funding gap and enable Project to proceed on the School's preferred timetable**
- **With good advance planning, effective solutions can be designed that**
  - optimize use of gift capital
  - structure debt to achieve overall Project timing and cost objectives
  - preserve the School's financial integrity and relationship with its donors

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