PIEDMONT UNIFIED SCHOOL DISTRICT

M E M O R A N D U M

TO: Board of Education

FROM: Randall Booker, Superintendent
Ruth Alahydoian, Chief Financial Officer

DATE: January 26,2022

RE: **LEASE FINANCING TO COMPLETE THEATER AND VRF PROJECTS**

I. SUMMARY

The Board is asked to consider a resolution that authorizes the District to enter into a lease-financing to complete the Measure H1 bond program, and to complete the ventilation and climate control upgrades (ventilation refrigerant flow, or VRF) in elementary classrooms. The lease structure is a financing tool that allows school districts to borrow for facilities projects.

Through this structure, the District will borrow not to exceed $4,000,000. The lender bank, through a competitive bid process, is Sterling National Bank (in the process of merging with Webster). The interest rate is 1.785%. The financing can be repaid starting in one year (prepayment penalties apply for the first five years). The up-front costs are approximately $120,000. Annual payments based on a borrowing of $3.2 million are approximately $355,000.

Piedmont Education Foundation has agreed to pay the up front costs and the interest for this financing, and to temporarily pay the principal. When the District receives state funding for the completed bond projects, the District will repay PEF any principal payments and ultimately use the State funds to repay the loan.

II. BACKGROUND

Need for funds. The voter-supported Measure H1 bond program provided $66 million for the construction of the STEAM building and a new performing arts center, along with a number of other facilities projects. The District has shared the progress of the program through several board presentations, presentations to the Facilities Steering Committee, and the Citizen's Bond Oversight Committee. The final stages of completion require $2.4 million in additional resources. The District expects to receive funds from the State School Facilities

Program to cover the remaining costs, however the timing of state funding is uncertain and could take up to five years.

Based on analysis and discussions with PEF, an external financing was determined to be the most cost-effective way to bridge the financing gap. PEF has agreed to support the District's financing (up to $1.8 million) by paying interest costs and temporarily paying principal. The District will be responsible for the interest on the remaining portion.

In addition to the final costs of the bond program, the District is completing the third and final stage of ventilation upgrades at the elementary schools. The costs of this project, estimated to be $700,000, are also included in this borrowing and will be repaid by the District.

Financing Structure. Under California law, school districts are generally not authorized to incur debt without voter approval, but one of the recognized exceptions is a long-term lease financing. Under this mechanism, the district leases one of its essential properties to a counterparty at no cost, then subleases it back for rental payments. Such rental payments are then assigned to the lender, who has provided the loan. Lease obligations are considered a valid exception to the debt limit, since under the legal theory the borrower is deemed to be paying "rent" for the use and occupancy of the leased property -- if the building becomes unusable, the obligation is abated, and the borrower cannot be legally compelled to continue making payments until use of the building is restored (though there are various insurance and other requirements to safeguard against such disruptions).

The Resolution for the Board's consideration authorizes entering into a long-term tax-exempt Lease and Sublease Agreement (the "Agreement") in the amount of up to $4,000,000 for the purpose of financing the property acquisition. The Agreement relates to the Beach Elementary School, and the Public Property Financing Corporation of California has agreed to serve as counter party to the Agreement. Under the Agreement, the District will be required to make semi-annual lease payments pursuant to a payment schedule attached to the Agreement, payable from the District's general fund. The District will obtain funds to deposit in a project fund, which will be provided by a lending bank. Said bank will serve as the assignee under the Assignment Agreement, and will therefore be entitled to all lease payments to be made by the District under the Agreement, and is also entitled to enforce the terms of the Agreement. Additional proceeds will be used to pay all related financing costs.

Financing Team. The District has engaged our long-standing bond counsel, Jones Hall, and municipal advisor, KNN Public Finance, to assist with this financing. Public Property Financing Corporation of California (PPFCC) will serve as the financing corporations that will be the counterparty to the lease.

(While technically critical under the legal theory, in practice this is a perfunctory role, with relatively minimal involvement in the financing process.)

***Private Placement Approach*.** The District has historically sold its GO bonds through a competitive sale in the public municipal market, where interested underwriters submit bids, the bonds are awarded to the bidder providing the lowest true interest cost, and the winner then sells the bonds to various investors. As an alternative to a traditional public offering, some institutions (most often, banks) offer credit directly to local government issuers. The key advantage of a private placement is easier execution and lower issuance costs – they do not require ratings and formal disclosure. Given the size of the transaction, any interest rate difference between a public offering and a private placement would be offset by the higher issuance costs.

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On behalf of the District, KNN distributed a Request for Term Sheets to over 20 of the most active participants in this space. Seven banks submitted proposals, with Sterling National Bank (soon to merge with Webster Bank) providing the lowest interest rate, as well as other advantageous terms and conditions to closing. The financing team will be working with Webster Bank and their counsel on preparing the required documentation, with a targeted closing date – should the Board approve the proposed financing – of February 10.

Fiscal Impact. Based on a size of $3.2 million, the proposed interest rate of 1.785% for a 10-year term, and structuring for approximately level payments, the annual debt service for the proposed financing would come out to just over $353,000 per year, or a grand total of a little over $3.5 million over the life of the borrowing. Under the proposed terms, the District will have the ability to prepay the obligation without penalty on or after February 1, 2027 (also pre-payable sooner but with a 1-2% premium).

The District expects to receive State funding to cover the entire amount borrowed. PEF has agreed to pay interest costs on the $1.8 million portion that is to complete the theater. The District will cover the remaining payment expenses from the general fund or other allowable funds.

Documentation. Presented for the Board's consideration are the following:

- **Authorizing Resolution**, approving the financing documents in substantially the form presented, and authorizing staff to execute within the not-to-exceed parameters ($4 million size, 3% rate, 10-year term)
- **Lease/Sublease Agreement**, in substantially final form, between the District and PPFCC – the main financing document, containing the key terms of the borrowing, as well as various requirements, covenants and representations taken on and made by the District

- **Assignment Agreement**, in substantially final form, between PPFCC and Webster Bank, the proposed lender, through which PPFCC assigns to the lender all its rights under the lease/sublease

III. RECOMMENDATION

APPROVE RESOLUTION No. 21-2021-22 OF THE BOARD OF EDUCATION OF THE PIEDMONT UNIFIED SCHOOL DISTRICT AUTHORIZING EXECUTION AND DELIVERY OF A LEASE AND SUBLEASE AGREEMENT AND RELATED DOCUMENTS AND ACTIONS