

INNOVATIVE FINANCING STRATEGIES TO CREATE OPERATIONAL CASH-FLOW DURING TIMES OF COVID-19

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In early 2018, we published an HJ Sims Perspective discussing the changes to the tax code enacted as part of the Tax Cuts and Jobs Act. It provided guidance on how the Act would impact financings in the foreseeable future. This HJ Sims Perspective provides examples of how HJ Sims has assisted its clients in facilitating advantageous financing results, despite the elimination of advance refundings and increased corporate tax rates for their lending partners.

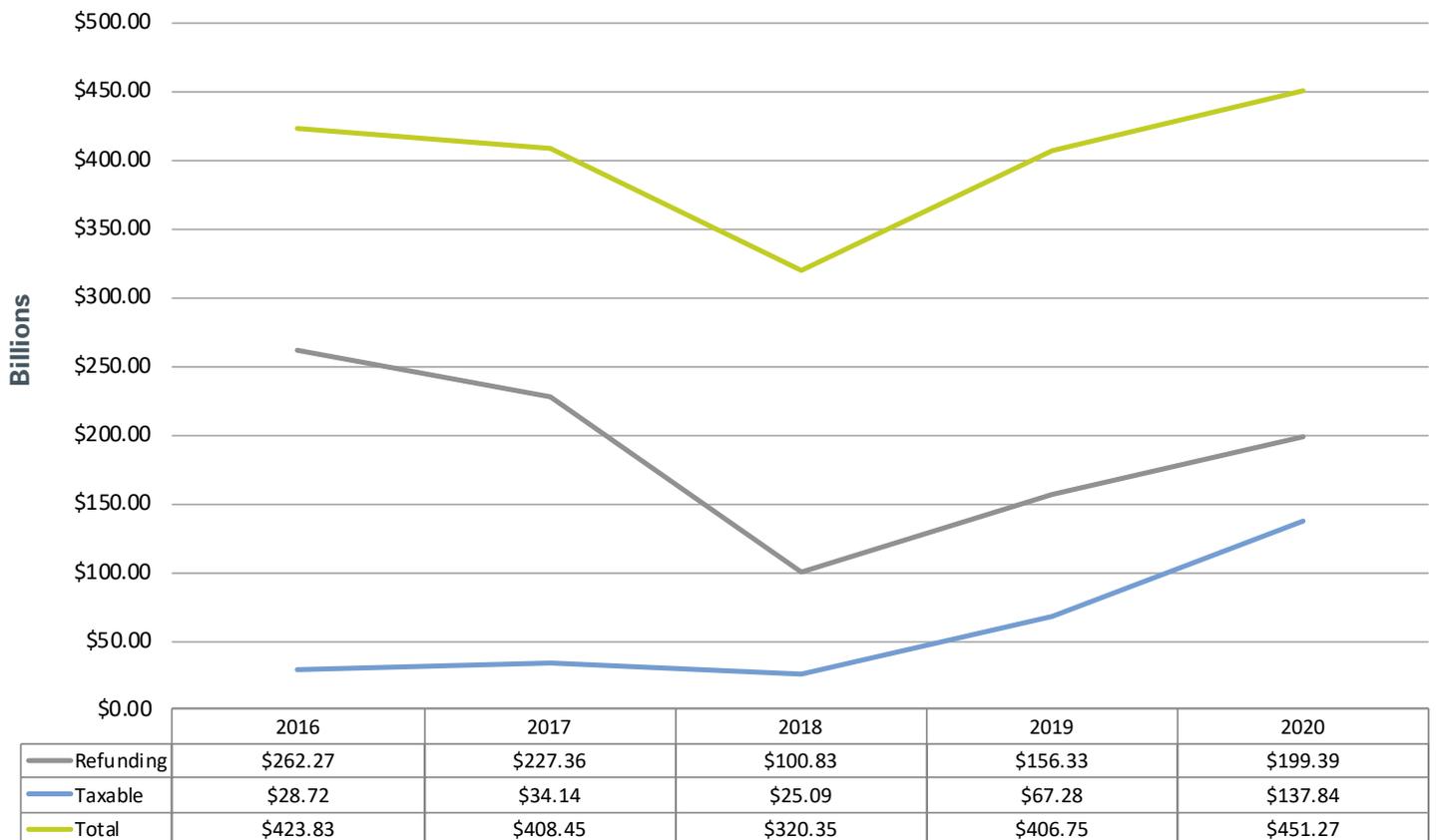
Recalling the Impact of the Tax Cuts and Jobs Act

First introduced by the House of Representatives on November 2, 2017, and concluding with the President signing it into law on December 22, 2017,

the Tax Cuts and Jobs Act (“the Act”) was the first substantial tax overhaul since the 1986 Tax Reform Act.

The primary impact on the municipal bond market was through the elimination of advance refundings, which represented nearly 27% of total market

Total Volume and Volume of Refunding and Taxable Bonds (2016 - 2020)



volume in 2016, according to Thomson Reuters. In addition, the reduction of the corporate income tax rate to 21% triggered an automatic adjustment to interest rates borne by non-profit borrowers on existing bank debt, increasing debt service as the benefit of the tax-exemption on the interest income was less valuable to bank lenders.

The graph below shows the aggregate volume of municipal bonds issued in the years 2016 through 2020, alongside bond issuance for refundings and bond issuance done on a taxable basis. In 2018, there was a significant reduction in primary market bond sales due to the glut of transactions that were brought in the end of 2017, as Congress threatened not only tax-exempt advance refundings (eventually eliminating them), but also tax-exempt private activity bonds (“PABs”), which were eventually saved. As the bond market rebounded in 2019 and 2020, and taxable rates remained at or near historic lows, the taxable bond market began to accommodate a greater volume of advance refunding debt, albeit for more highly rated borrowers. In the segments below, we discuss how we assisted clients in navigating the changing bond landscape after the Tax Cuts and Jobs Act.

Structured Right: How Financing Terms Changed

In 2018, we provided guidance on the projected alternatives for advance refundings and projections for changes to future bond issuances’ call provisions based upon the impact of the Tax Cuts and Jobs Act. Of those prognostications, the primary forms of alternatives utilized in the market have been (1) “Cinderella” bank-held bonds, (2) taxable fixed-rate advanced refundings, (3) forward refundings and (4) tender offers.

Advance Refunding Alternatives for Outstanding Bond Issues, in Practice

1. “Cinderella” Bonds

In this type of financing, the borrower enters into a financing advance refunding the outstanding tax-exempt bonds on a taxable basis, usually with a

bank lender. Then the taxable refunding bonds automatically convert to tax-exempt refunding bonds at the earlier of: (i) midnight ninety days prior to the call date of the “refunded” bonds (hence the Cinderella reference) or (ii) the reversal of the advance refunding prohibition. This eliminates interest rate risk after the escrow period as pricing and terms for the tax-exempt refunding bonds are agreed at the time the taxable refunding bonds are executed. Read more about this structure in action in this **Marshes of Skidaway Island** synopsis:

Cinderella Bond Example:

Marshes of Skidaway Island is an LCS-managed life plan community located on 58 acres on Skidaway Island just outside of Savannah, Georgia. HJ Sims has partnered with The Marshes since their inaugural financing in 2003. In 2020, HJ Sims approached The Marshes noting that a bank-placed Cinderella refinancing of the outstanding fixed rate Series 2013 Bonds would provide significant savings. HJ Sims facilitated a bank request for proposals process, ultimately resulting in the closing of a successful \$47.1 million financing on December 7, 2020, with a matched amortization and a 12-year term. The financing consisted entirely of directly placed Cinderella Bonds which will utilize a taxable structure and convert to a tax-exempt mode shortly before the call date of the 2013 Bonds. HJ Sims also advised The Marshes on procuring a swap for the refunding bank loan. The taxable swap was priced to reflect market conditions at 1.627% as was the tax-exempt cancellable forward swap at 2.375%. The swap is cancellable at and after year eight without any mark-to-market to provide flexibility for The Marshes. Ultimately, the refinancing will save the Marshes approximately \$1.14 million annually and \$15.36 million through the twelve-year bank commitment. [Full Case Study](#)

2. Taxable Advance Refunding

As interest rates returned to near historic lows in 2019 and 2020, the cost of taxable fixed rate bonds, especially investment-grade rated, decreased. In a number of circumstances, borrowers were able to utilize taxable municipal fixed-rate bonds to refinance tax-exempt municipal fixed rate bonds on an advance basis and still achieve material savings. Read more about this structure in action in the **Westminster Communities of Florida** synopsis below.

Taxable Advance Refundings Example:

Westminster Communities of Florida (formerly Presbyterian Retirement Communities) is a Fitch A- rated obligor and the largest provider of life plan communities in the State of Florida with a total of 3,500+ units, including nearly 2,300 residential units, 515 assisted living units and approximately 780 skilled nursing units.

In 2017, Westminster acquired the twice-bankrupt Glenmoor community out of bankruptcy in a bond financing that involved both taxable and tax-exempt bonds at rates of 5.5% and 4.125%, respectively (the “Series 2017 Bonds”). After a few short years under the management of Westminster, the re-coined Westminster St. Augustine (formerly, Glenmoor) had completed its turnaround, experiencing a 13% increase in occupancy, significant boost in days cash-on-hand and superior debt service coverage.

It was time to bring Westminster St. Augustine into the Presbyterian Retirement Communities Obligated Group, but the Series 2017 Bonds were not callable until October 1, 2022. HJ Sims worked with the team at Westminster to analyze both a bank-held Cinderella refinancing and a taxable advanced refunding. Ultimately, Westminster decided to proceed with a taxable advanced refunding of the Series 2017 Bonds, bringing Westminster St. Augustine into the Obligated Group as a tax-exempt current refunding of the variable rate Series 2010B Bonds, and a tax-exempt new money issuance to fund a portion of a number of upcoming capital projects.

Due to the financial strength of Westminster, and the taxable bond structure proposed by HJ Sims utilizing two medium term taxable bonds maturing in 2025 and 2028, and the balance of the taxable bonds amortizing between 2048 and 2050, HJ Sims was able to procure strong investor interest in both the taxable and the tax-exempt bonds. The \$107,360,000 financing featured an all-in true interest cost of 3.87% through 2055, no debt service reserve fund, long-term bonds with 4% coupons, and a 5-year optional call.

[Full Case Study](#)

3. Forward Refunding

This type of financing utilizes tax-exempt fixed-rate bonds that are priced on a present-day basis, but not delivered and “closed” until ninety days prior to the call date of the refunded bonds. As supply in the bond market decreased starting in 2018, investors became more willing to make longer term forward commitments, albeit at a price of 4-5 basis points on average per month between the pricing and the closing date. Read more about this structure in action in the **Peconic Landing** synopsis below.

Forward Refunding Example:

Peconic Landing at Southold is a life plan community located in Greenport, New York on Long Island’s North Fork. Peconic Landing is operated under a cooperative model and has 296 independent living apartments and cottages, 42 assisted living units and 60 skilled nursing beds on more than 145 acres with 2,700 feet of private beach on Long Island Sound. HJ Sims and Peconic Landing have partnered together since 2000, when the inaugural financing for the community closed.

In 2019, HJ Sims discussed with Peconic Landing the potential refunding of its Series 2010 Bonds, which were not callable until

December 1, 2020. The long-term bonds had coupons of 5.875% and 6.000%, and with Peconic Landing's Fitch rating of BBB-, it was anticipated that Peconic Landing could achieve savings at then-current market rates. However, the elimination of tax-exempt advance refundings meant immediate access to the tax-exempt market was not possible, and their BBB- rating meant that access to the taxable bond market would not be practicable.

HJ Sims worked closely with Peconic Landing, legal counsel and our underwriting desk to facilitate a forward refunding whereby HJ Sims priced the tax-exempt refunding bonds alongside a current issuance of new money bonds for capital expenditures in late 2019. The aggregate \$24.29 million bond issuance closed on December 12, 2019, with settlement of the Series 2019B Bonds (the bonds refunding the Series 2010 Bonds) to occur in November 2020. Through the forward delivery mechanism, Peconic Landing had secured a 20-year term on its refunding at a maximum yield of 3.45%, a 0.45% premium over the bonds settling on the closing date. Notwithstanding the incurrence of \$1.965 million of additional debt, HJ Sims was able to save Peconic Landing \$300,000+ in annual debt service. In November 2020, as the market eyed the impending election and the COVID-19 pandemic raged on, the forward delivery for the Series 2019B Bonds settled.

[Full Case Study](#)

4. Tender Offer

In this financing, a borrower engages HJ Sims to act as its Tender Agent and solicit existing bondholders to surrender their bonds for purchase. Bonds would be tendered at a price that is either: (i) similar to the price at which these bonds are trading or (ii) reflective of their "make-whole" value. Read more about this structure in action in the **Asbury Maryland Obligated Group** synopsis below.

Tender Offer Example:

Asbury Communities owns and operates life plan communities in Pennsylvania, Maryland and Tennessee, as well as HUD Section 202 senior housing buildings, a foundation, and a for-profit technology consulting firm. In 2018, Asbury Communities selected HJ Sims to be its investment banking partner.

One of the challenges inherent in the Asbury Maryland Obligated Group's capital stack was a series of outstanding bonds placed directly with an institutional investor in 2014 with a 5.000% coupon and without an optional call feature (the "Series 2014 Bonds"). The Series 2014 Bonds were issued in the original principal amount of \$15,290,000 and had a balloon payment structure with principal payments of \$1,515,000 on January 1, 2020 and \$13,775,000 on January 1, 2021. This balloon structure created an irregular bond repayment schedule and pressured cash in the 2021 fiscal year.

As a result, HJ Sims engaged in conversations with the existing bondholder to negotiate an exchange of the Series 2014 Bonds at a purchase price that approximated a make-whole price for a new \$13,555,000 series of bonds issued in 2018 (the "Series 2018B Bonds"). In structuring the Series 2018B Bonds that would fund the purchase price of the Series 2014 Bonds and would be purchased by the existing bondholder, it became clear that it was important to maintain the relatively short-term nature of the Series 2014 Bonds. HJ Sims was able to extend the amortization until 2027, providing six additional years of repayment and layering the amortization of the Series 2018B Bonds into the overall capital stack of Asbury Maryland Obligated Group. Finally, while the coupon for the Series 2018B Bonds was the same as the coupon for the Series 2014 Bonds, the Series 2018B Bonds were issued at a price of 112.956, reducing the overall debt burden of Asbury Maryland Obligated Group.

[Full Case Study](#)

Mitigating the Impact of Changed Corporate Tax Rate

A spate of amendments in early 2018 addressed the change to the corporate income tax rate. Tax-exempt bank debt bears interest at a rate multiplied by a percentage called the “Tax Factor.” The Tax Factor is essentially 1% minus the income tax rate of the particular bank lending institution. When corporate tax rates were in the thirtieth percentile, the Tax Factor was in the sixtieth percentile. When corporate tax rates decreased overnight to the twentieth percentile, the Tax Factor neared 80%. This had the unfortunate consequence of increasing interest expense after most entities had completed their budgeting process. Because the debt is tax-exempt, there are limited amendments that can be made without it triggering a “reissuance” of the debt. Reissuance becomes a challenge as it would require a new bond counsel opinion and may require a new Tax Equity and Fiscal Responsibility Act (“TEFRA”) hearing. It is a costly and time-consuming endeavor for all involved. HJ Sims worked closely alongside its clients and bond counsel in a number of circumstances to facilitate two types of amendments—first, ensuring that the language adjusting the Tax Factor was bilateral and second, reducing the impact of the increased Tax Factor.

In the first circumstance, we assisted clients in procuring amendments to their existing documents that would ensure that if the corporate tax rate were to be increased (as it may be under the Biden administration), the Tax Factor would see a corresponding decrease. Some bank documents only had the effect of increasing the Tax Factor in the event of a decrease in corporate tax rate and not a corresponding decrease in the Tax Factor in the event of an increase in the corporate tax rate.

In the second circumstance, we assisted some clients in negotiating with their lenders a reduction in the impact of the increase in the Tax Factor—whether by excluding from interest expense as part of the debt service coverage ratio that portion

of additional interest that had not been included in the budget for that fiscal year to avoid any covenant defaults, or by amending the credit margin on the interest rate in an amount that would not trigger a reissuance, but would somewhat mitigate the increase in the Tax Factor. The latter amendments were not widely adopted by the bank lending community, but were able to be procured in some circumstances.

Financed Right: Staying Committed to our Can-do Approach

Without question, tax reform has changed the borrowing landscape for 501(c)(3) organizations. Through application of HJ Sims’ Financed Right® approach, HJ Sims demonstrates our ability to assist clients in navigating the ever-changing bond market landscape.

As we look toward the next two years of a Democratically-controlled Congress and White House, the question will remain whether tax-exempt advance refundings will be resurrected and to what extent the corporate tax rate may increase. In any event, we also expect to see the taxable primary market begin to dip its toes into the lower-rated and non-rated, high-quality bond issuances as investors search for yield and investment opportunities.

In the weeks and months ahead, HJ Sims will continue to monitor and test market response to these new laws and update the industry of new developments and trends as they unfold.

To further discuss strategies for cash-flow during COVID, contact your HJ Sims banker:

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