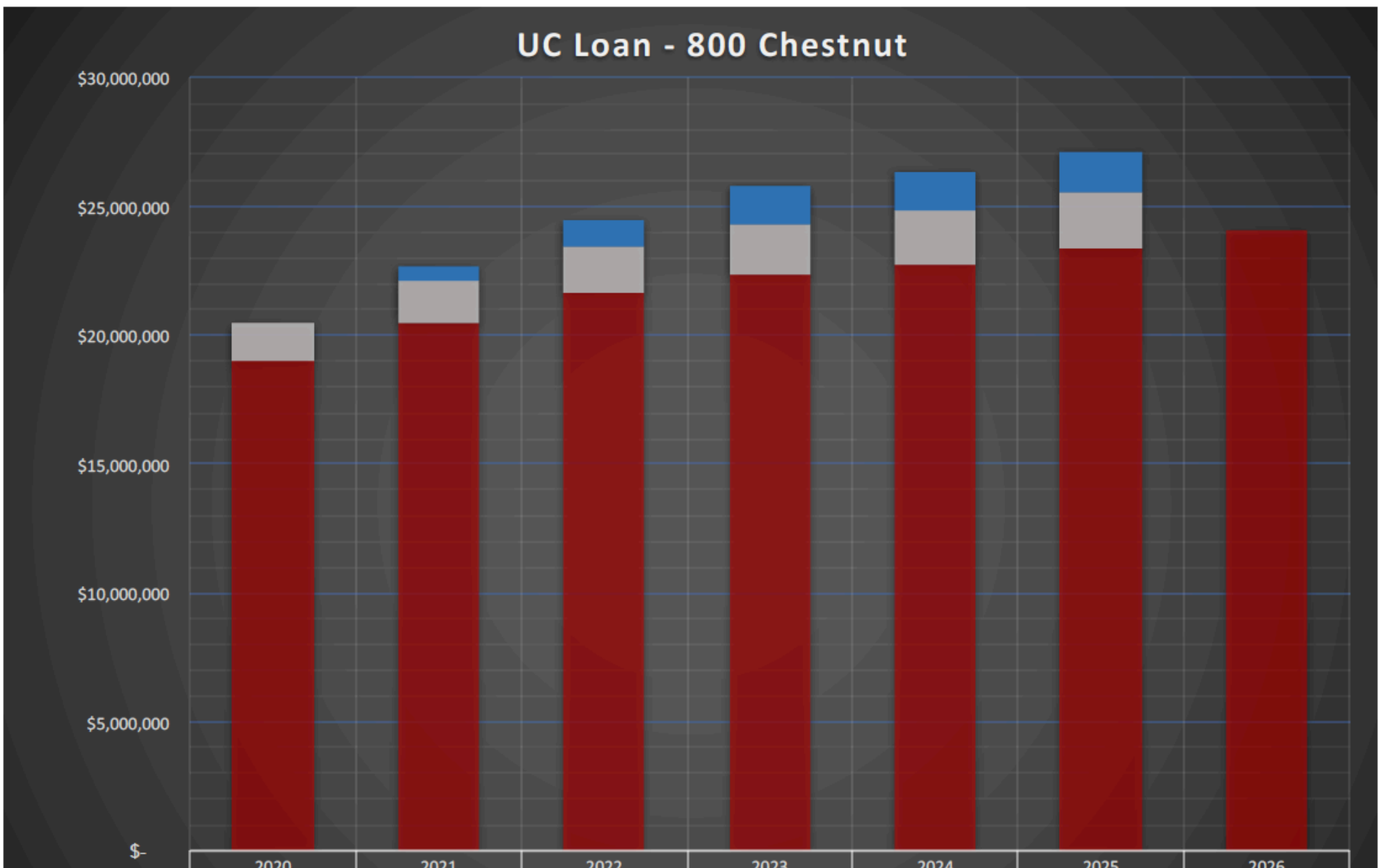
Finance Subcommittee

Presentation to the Reimagine Committee

January 14, 2021

There are two matters that are separate but related in the long-term financial health of SFAI: the massive debt obligation the school faces and the operational health of the school with a severely diminished enrollment. These matters are related in that solving the debt problem may well depend upon reestablishing the operational viability of SFAI through increased enrollment.

We are all familiar with the debt that was taken on for the build-out at Fort Mason. Last spring, SFAI was in default of the terms of the loan agreement, and the lender looked to foreclosure.



	2020	2021	2022	2023	2024	2025	2026
Yearly Payments	$-	$510,000	$1,050,000	$1,500,000	$1,500,000	$1,500,000	
8% Interest	$1,520,000	$1,640,000	$1,770,000	$1,910,000	$2,070,000	$2,230,000	
Yearly Balance	$19,000,000	$20,520,000	$21,650,000	$22,370,000	$22,780,000	$23,350,000	$24,080,000

The board negotiated a deal with the UC Regents to pay off our debt of $19 million in 2020, with a six year agreement calling for interim rent payments and a balloon payment due at the end. Interest accrues and compounds at 8%, and the debt grows to $30.14 million over the period of the agreement. The interim rent payments SFAI will be making total $6.1 million, and this amount is to be credited to the accrued debt balance, such that SFAI has to repay $24.1 million in **2027** to reclaim the campus. Default on the balloon payment will result in forfeiture of 800 Chestnut.

Given this debt challenge, our focus in the Finance Subcommittee has been to understand the near and long-term financial outlook of SFAI under a range of scenarios, including the options developed by the Reimagine Committee. To establish the economic viability of those options, we built several financial models based upon existing detailed financial data provided by the SFAI Finance team.

For modeling purposes, we developed expense estimates and then simplified the numbers for analytical and presentation purposes by categorizing and summarizing the expenses according to certain dynamics, specifically, whether they related to the real estate, to administrative expenses, or to faculty. We did this because the real estate costs, being the lease payments for Fort Mason and now the rents we pay to the UC Regents for 800 Chestnut, are fixed and must be paid no matter the status of the institute.

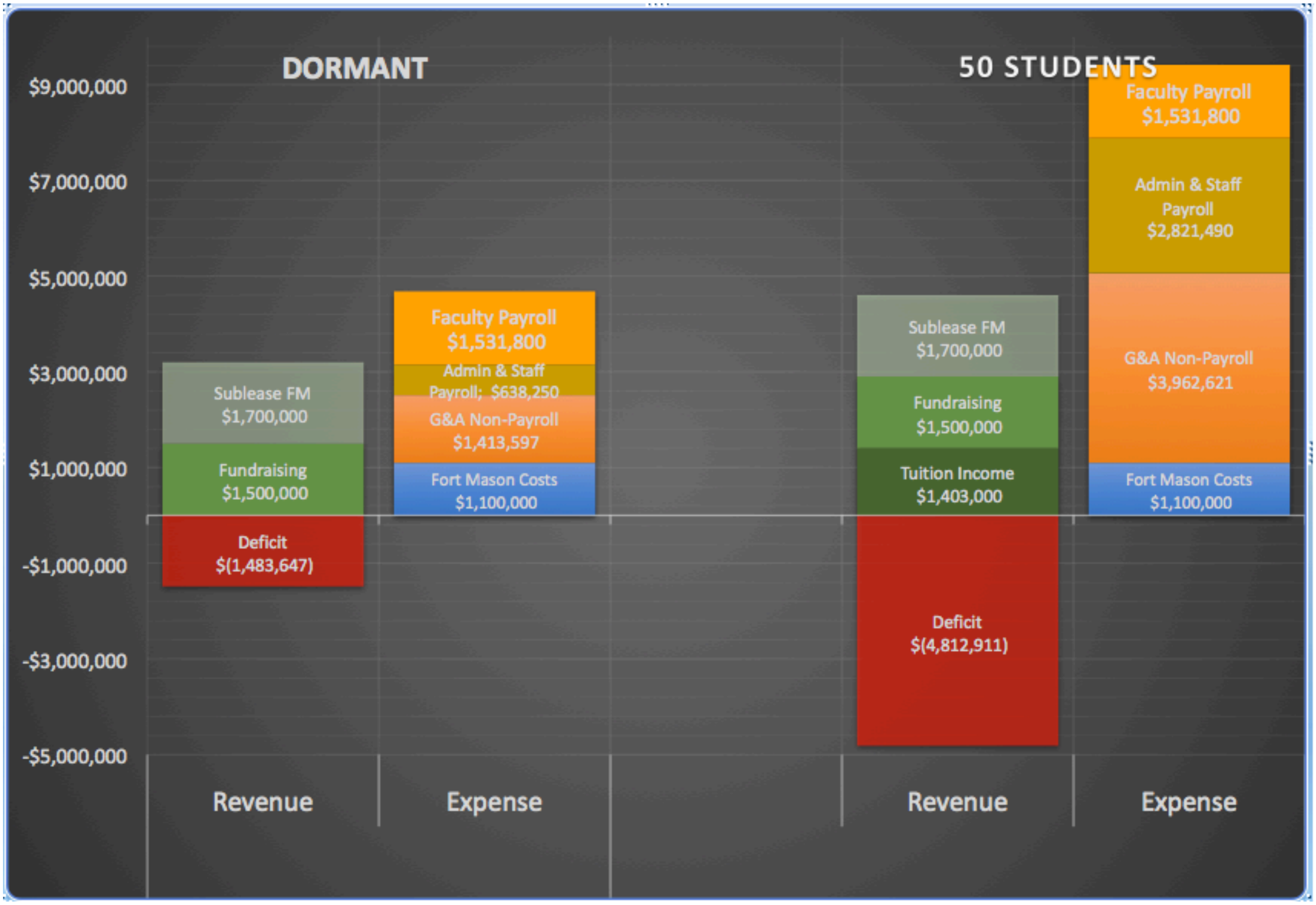
Operating SFAI also requires a level of administrative staffing for functions such as admissions, registrar, financial aid, etc. We have summarized these costs as Administrative Staff Payroll.

There are also other necessary Administrative costs to keep current with contracts, legal requirements and financial reporting, and expenses such as insurance and IT systems. These expenses are largely unavoidable but do not vary much with the size of enrollment.

The only expense that the school has that moves directly with enrollment is faculty payroll. The more students you have, the more classes you teach, the more faculty you need.

On the revenue side, other than tuition, the income for the school would come from a minor amount of earnings from the endowment, subleasing revenues for the space at Fort Mason, and finally contributions and other fundraising.

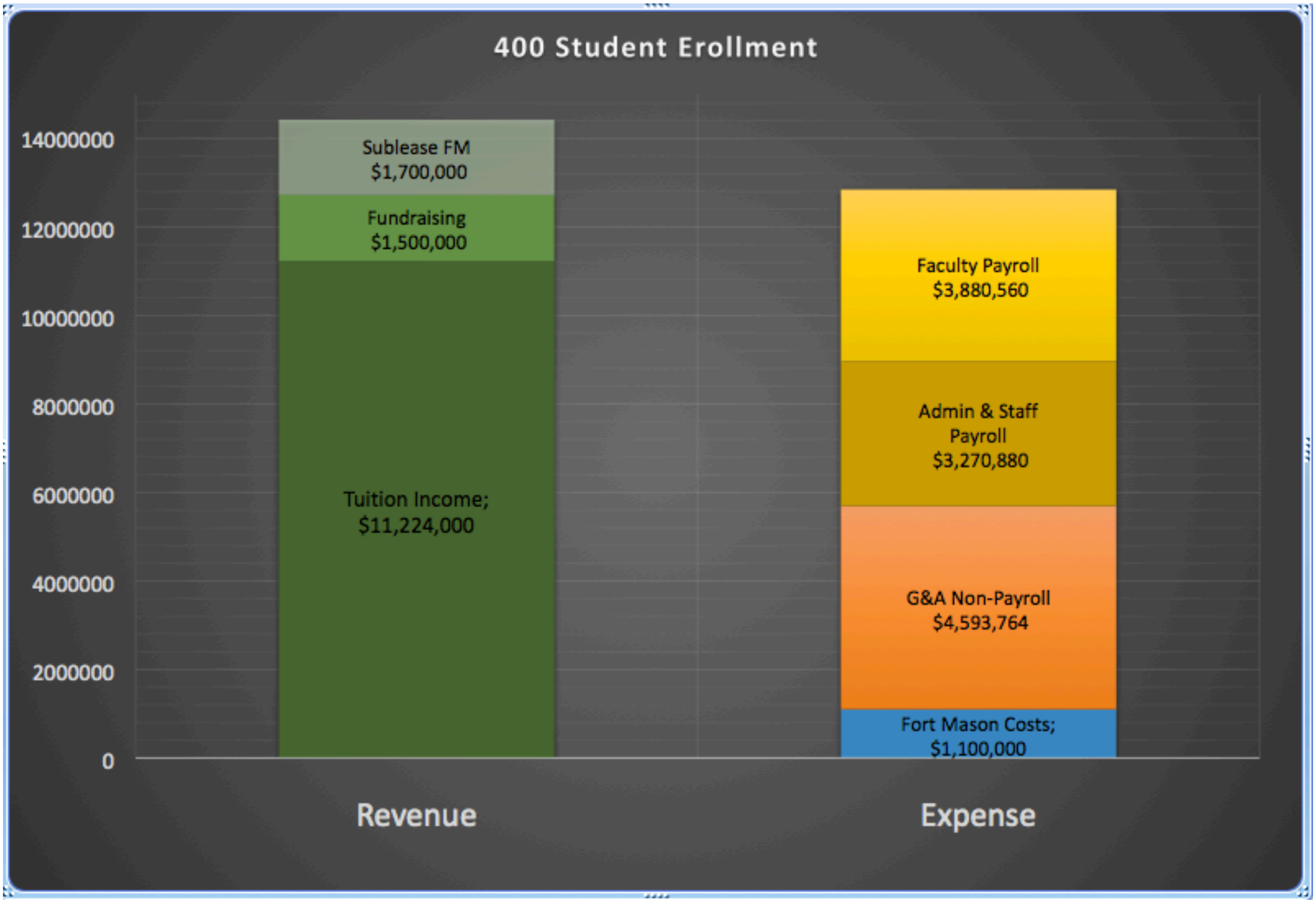
With the data we compiled, we looked at two near-term scenarios – first, that the school continues to operate in Fall 2021, next year, assuming a minimal enrollment of 50 students and at the current tuition of $46,000; second, as an alternative, the school goes back into dormancy for a year.



Looking at the first case, which are the bars on the right of this graph, if the school remains open and has 50 students next year, operating with the administrative staff we have today, and also assuming that we generate $3.15 million from subleasing Fort Mason, contributions and other fund raising, our operating costs would exceed our revenue by $4.8 million. Given what Tom took you through at the beginning of the meeting, this is $4.8 million that is not currently funded.

In the second case, we looked at closing the school for a year, giving us time to finish the work of the Reimagine Committee, consider new approaches or structures, and also give more time for the Board to look for strategic partnerships with the City and other schools or foundations. Is this scenario, there are no students or tuition income. We still would incur some administrative staffing costs, such as development, and some general and administrative expenses for legal and accounting, insurance, etc., but we would save on overhead, utilities, IT costs and other things.
In this case, we assumed that the tenured faculty would remain, however, for three reasons: first, the school would have to pay them a substantial portion of their contracts anyway; second, they could help with the reimagining, and third, we would need them to reopen in 2022.

In this scenario, which assumes that we would still raise funds through contributions and subleasing Fort Mason, there remains an operating deficit of $1.5 million. This is still a problem, but $3.3 million less of a problem than opening and teaching next year.



Finally, we also modeled a what-if scenario to see what it would take to have a glimmer of hope to refinance our debt with the UC Regents when it comes due. And our analysis shows that, under the current operating structure, and with tuition remaining at $46,000, that an enrollment of around 400 would be required to generate a strong enough cash flow to negotiate with potential lenders. And even in this extremely challenging scenario, the school could incur additional deficits of $6 to 10 million while building up to that level of enrollment, and that would also have to be rolled into the refinancing. Without some form of short-term bridge financing, this may all be a pipe-dream. We don't have an answer for this.

Our conclusion, and the only recommendation the finance subcommittee is in position to make at this time, is that we take the route of dormancy and reimagination in 2021-2022 as a means of relieving some of the financial pressure and buying time to develop a successful future for SFAI.