

Memo

To: John C. Randolph
From: Scott L. McMullen
Date: June 22, 2018
Subject: Town of Palm Beach – Friends of Recreation, Inc.

Skip:

This Memorandum is in response to your email to me of June 20, 2018 regarding the proposed Friends of Recreation Capital Grant Agreement with the Town of Palm Beach. Based on your email to me and my review of the background materials that you forwarded to me, my understanding of the pertinent facts are as follows:

- The Town of Palm Beach desires to construct a new recreation facility in the Town of Palm Beach, the estimated cost of which is up to \$15m. It is estimated that the project would take approximately 14 months to complete following commencement of construction. The cost of the project would be funded as follows:
 - The Town would pay one-third of the total cost (estimated at \$5m).
 - Friends of Recreation, Inc. (“FOR”) would pay one-third of the total cost up to \$5m by way of cash contributions and pledges received by FOR from members of the community in connection with an ongoing capital campaign for the project. FOR has already received cash donations of approximately \$2.5m and has received pledges of at least an additional \$1.8m with more expected to bring said pledges up to an estimated \$2.5m. FOR is a Florida non-profit corporation that has no assets other than the \$2.5m cash it has raised, together with the additional pledges of approximately \$2.5m.
 - The Morton and Barbara Mandel Family Foundation (the “Foundation”) would match the cash contributions and “quality pledges” received by FOR, up to \$5m, in accordance with a Capital Grant Agreement between the Foundation and the Town dated August 8, 2016 (the “Foundation Agreement”).

- The Town has approved the proposed Capital Grant Agreement with FOR (the "FOR Agreement"), as reflected in Resolution No. 63-2018, contingent upon your review and approval of same to assure that the Town is secure in its ability to receive the up to \$5m payment promised by FOR.
- You have asked me to provide my opinion on whether the \$5m payment from FOR is, in fact, secure.

As noted above, FOR has received cash donations of approximately \$2.5m, which I understand is currently being held in a Northern Trust account. You suggested that the \$2.5m in cash be transferred to the Town's construction account and be disbursed in accordance with the terms of the FOR Agreement as construction progresses. I agree with your suggestion and recommend that the form of the FOR Agreement be modified accordingly.

As to the additional pledges up to \$2.5m, it is my understanding that some of the pledges are payable by the donors to FOR over as long as a 5 year period, so the timing of FOR's receipt of the pledges will not coincide with FOR's construction draw requirements under the FOR Agreement, which are all expected to be due and payable within the next 2 years. As a result, FOR has made application with The Northern Trust Company ("Northern") to obtain a \$2.5m line of credit (the "LOC"), to be secured by an agreement encumbering the donor pledges, which would provide FOR with the liquidity necessary to pay construction draws to the Town as and when they come due. In connection therewith, FOR has provided a copy of a Loan Commitment Letter dated May 29, 2018 between Northern and FOR, the material terms of which include the following:

- A line of credit in the amount of up to \$2.5m, with a borrowing base of up to 100% of "eligible pledges", which are defined as "pledges evidenced by a completed, signed pledge card provided to the Bank and reported by the Borrower on a monthly pledge report".
- A term of 2 years.
- Payment of accrued interest monthly, with the interest rate being Overnight LIBOR + 200 basis points (which would make the current rate approximately 3.93% +/-).
- FOR to apply all collected pledge receipts to the LOC balance.
- The loan documents to contain "such usual types of representations, warranties, covenants, events of default and other conditions as are required by Northern".

My thoughts on the LOC are:

1. Assuming that (i) closing occurs on the LOC in accordance with the terms of the loan commitment letter, and (ii) FOR delivers to Northern evidence of “eligible pledges” equal to or greater than \$2.5m, then FOR will have access to funds sufficient to satisfy FOR’s funding requirements under the FOR Agreement.
2. The LOC should provide some comfort to the Town that FOR will be in a financial position to comply with the terms of the FOR Agreement. Notwithstanding, I would not characterize FOR’s obligations under the FOR Agreement as being “secure” from the Town’s perspective, for the following reasons:
 - a. In the event FOR fails or refuses to perform under the FOR Agreement by failing or refusing to pay a construction draw upon request of the Town in accordance with the draw schedule contained in the FOR Agreement, the Town could not demand payment from Northern under the LOC, as the Town would not be a party to the LOC credit facility.
 - b. Draws under the LOC by FOR could be suspended by Northern in the event of a default under the terms and conditions set forth in the loan documents evidencing the LOC. While we have not seen drafts of those loan documents, in theory, FOR could default under some loan covenant contained therein (such as failing to pay outstanding interest when due, failing to apply pledges received to the outstanding principal balance of the LOC, failing to comply with reporting requirements or failing to comply with any other covenant contained in the loan documents), which default could result in FOR being unable to make further draws on the LOC.
 - c. Again, while we have not received drafts of the loan documents, it is possible that draws under the LOC could be suspended or a default declared under the LOC if Northern “deems itself insecure”, which could happen if a major donor defaults on a pledge, files bankruptcy, etc.

In my opinion, the only way that the Town could be deemed “secure” would be by one of the following methods:

1. FOR immediately drawing the full \$2.5m on the LOC and placing the proceeds in the Town’s construction account. This would obviously result in interest expense to FOR which FOR would not want to incur;
or
2. Northern issuing an irrevocable standby letter of credit (an “LC”) in favor of the Town in the amount of \$2.5m, pursuant to which the Town

would be able to immediately draw upon the LC in the event that FOR fails to comply with the terms of the FOR Agreement. Unlike the LOC, the LC would be an agreement directly between the Town and Northern which gives the Town the right to demand payment from Northern in the event of a default by FOR under the FOR Agreement; or

3. Some other third party with significant unencumbered assets guarantees the obligations of FOR under the FOR Agreement and/or pledges assets as collateral for such obligations.

Please call me if you wish to discuss.