



LOOP CAPITAL MARKETS

MEMORANDUM

TO: Janet Rice Elman
Executive Director
Association of Children's Museums

FROM: Loop Capital Markets LLC

DATE: April 22, 2009

RE: ACM Leadership Call Follow-Up

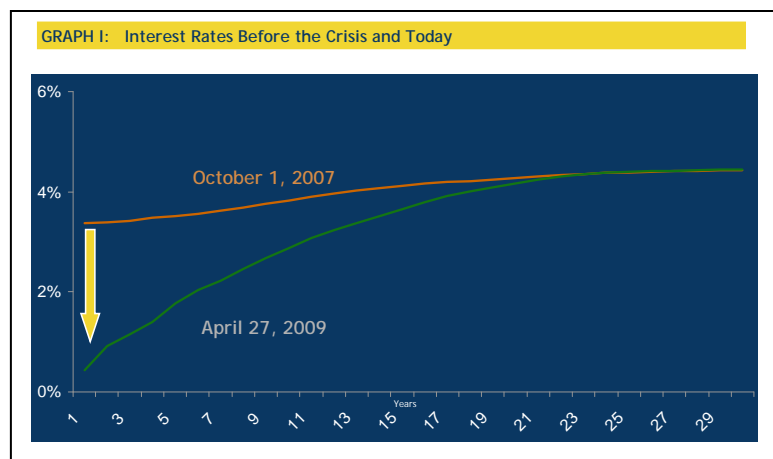
Thank you very much for the opportunity to co-moderate the Association of Children's Museums leadership call with Shelley Goode on managing a capital campaign during a recession. I really enjoyed the dialogue with the museums on the line and I hope your members found the discussion informative.

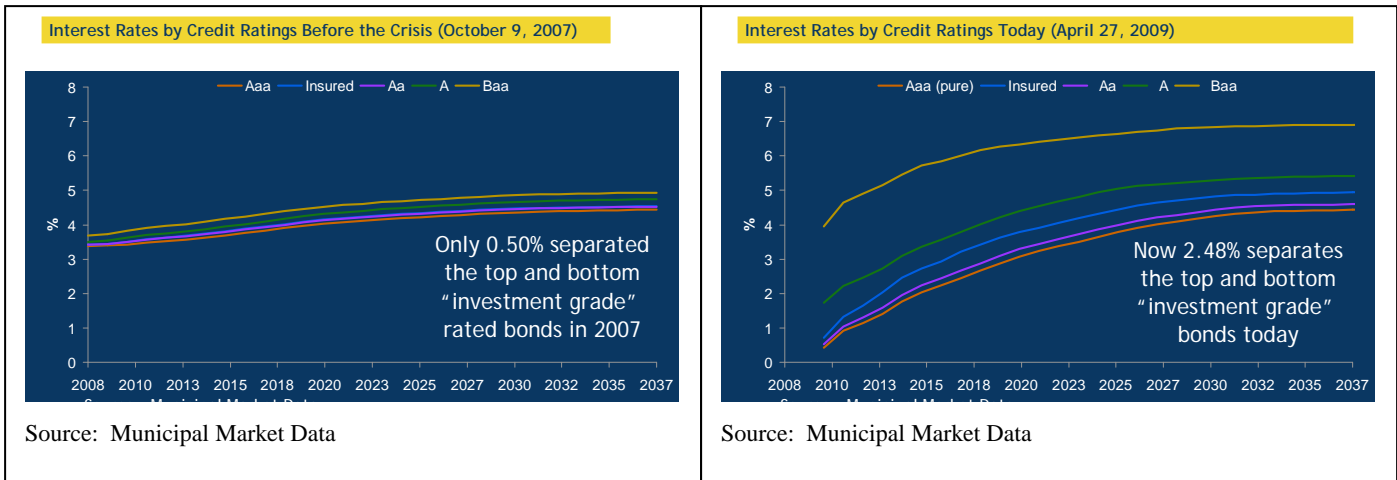
As I mentioned, some financial concepts are more easily visualized than described over the phone. I thought the leaders who were on your conference call might find a quick recap with charts helpful. Please feel free to incorporate the following into your dissemination of materials to the group.

Overview

Over the past year and half, during what has been termed one of the worst financial crises in a century, there is no question that financing has gotten more difficult to obtain; the terms on which financing is offered are more onerous and in many cases obtaining financing has become more expensive.

The good news, however is that financing is available and projects are getting done. After some particularly painful episodes last year, including the collapse of Lehman Brothers, the markets are easing up. Indeed for certain types of borrowing – variable rate financing, for example - interest rates are at unprecedented and historic lows. In addition, bidding conditions for building construction have become quite favorable (at least until the Federal stimulus package creates more demand for construction materials and contractors).





Interest rates have fluctuated since the Fall of 2007. As shown in Graph 1 on page 1, however, the net impact of the interest rate changes over the last 19 months has been that long term rates for highly rated tax exempt borrowers are nearly unchanged from where they were, but short term rates are down very dramatically. However, the even bigger change and the bad news for most museums when it comes to interest rates, is shown at the top of this page. The spread between rates for borrowers with different credit ratings has gotten quite wide. In October 2007 at the beginning of the financial crisis, the difference between the rates paid by the borrower with the strongest investment grade rating (Aaa) and the borrower with the weakest investment grade rating (Baa) was about 0.50%. Today that spread is about 2.58%. Low investment grade bonds are now pricing at nearly 7% for 30 year debt. As we already saw on Graph 1, the long-term rate for highly rated Aaa entities is almost unchanged – the biggest change in the current market place is that the cost of borrowing for the weakest borrowers has increased tremendously.

These market conditions would not have been so concerning if there were still Aaa/AAA rated bond insurers available to insure the bonds of relatively weaker museums, but Aaa/AAA bond insurance has all but disappeared as nearly all the Aaa/AAA bond insurers have lost their high ratings. The remaining bond insurers are not insuring museums. So we have had to develop new strategies in order not to have low-rated museums issuing bonds with rates of nearly 7%. Sometimes this has involved a very strategic approach to acquiring bank letters of credit to enhance the rating on the bonds so that the bonds are sold based on the banks high rating, rather than the museums relative low rating. Sometimes this strategy has involved assembling portions of the letter of credit from multiple banks and accessing banks from other parts of the country or even other parts of the world, which are able to offer more favorable pricing and business terms. This may also include various strategies using variable rate debt and other techniques for accessing the rates on the low end (i.e. left side of the graphs above) of these yield curves.

We suggested on the call that there are some important points to remember:

- First, borrowing is just a vehicle to address the timing of money. But financing does not pay for the project; the project has to be paid for from other sources. Financing can be used to help a museum preserve cash; give a museum more time to convert future pledges to cash by “monetizing” future pledges into up front dollars; having the funds from a financing can allow you to lock in construction costs now, even before all the pledges are collected; and if structured properly, a sound financing plan should be able to help you to build reserves for the operation of a new or expanded museum. But financing can not substitute for the failure to raise the dollars for the project from somewhere; whether that is from a campaign, grants or even from future operations, the debt will need to be repaid and the dollars will need to come from somewhere.
- Second, when it comes to borrowing, some of the same truisms apply to museums that apply to each of us in our personal borrowing. This includes the fact that those who need financing the

least, will have the easiest time getting financing; and those who need it the *most*, will have the toughest time getting financing. One of the best ways to get access to credit is to get your institution's finances in order and to build reserves. Another important step is to have a very strategic approach to soliciting credit ratings, credit enhancement and borrowing.

- The corollary to that is that there is no one size approach to financing a museum – the approaches to financing museums are as varied as the museums themselves. This can be frustrating because it can mean there are no bright line rules. Many museums want to know, for example, how much they need to fundraise before they can borrow. While some individual financial institutions may have internal rules of thumb that sound simple, the truth is that the answer depends on each museum's individual situation. Those museums which have strong on-going operations and have managed to build reserves or an endowment will have the least onerous provisions. They will have the flexibility to borrow even if all their pledges have not been fully raised, let alone converted to cash. Conversely some museums which have not yet opened, do not yet have a physical presence yet, and don't have reserves – they will have the hardest time getting financing in this environment. The amount of fundraising that is required prior to financing is a continuum that depends on the individual facts of each museum's credit.

One of the key points to understand is that museums which are organized as 501c3 non-profits have the opportunity to borrow on a tax-exempt basis – they have the opportunity to use “advantaged” interest rate borrowing. This means they can borrow money through the issuance of tax-exempt bonds, for example, and the lender or investor in those bonds does not have to pay taxes on that interest. As a result, those investors typically are willing to accept a lower borrowing rate from these museums than from other borrowers. The important corollary to this is that using this borrowed money at “advantaged” interest rates may be cheaper for the museum than using investments or reserves (since those investments and reserves may be earning even higher interest or returns). That is why even institutions with as many resources as the Getty or Smithsonian, still will use this type of “tax-exempt” financing.

There are many financing tools – not just tax-exempt bonds – that can be used to finance a museum. The key is to make sure that you are analyzing both sides of your balance sheet – your assets and your liabilities – to develop a financing plan that optimizes that overall cost for your project. This means we are often running lots of different iterations of our financing models to find the optimal structure that satisfies each board's specific tolerance for “risk” and differences in interest rates produced by different structures. In the current market, we are also looking for leverage other tools, such as various types of tax credits when they are applicable.

Finally, however, I would caution that the fundraising campaign, the financing, and even the building project itself are merely means to an end. The real goal is to be able to operate a successful museum and that means having sufficient resources not merely to get the project built, but to be able to operate the facility after it opens. The pressure to conclude a campaign and the fatigue that sets in as the campaign nears its goal, can mean that many museums end their campaigns with “just enough” money to finish the building. But it is what happens after the building opens that is most important. If properly structured, the financing can be a tool as well for preserving cash and investments, making sure that the museum has sufficient cash and reserves on hand for operations, while the financing pays for the museum construction itself.

It was a great pleasure speaking with your ACM colleagues and members on the Leadership Call. There is much more to discuss on this topic and I am looking forward to exploring these issues further during the session at InterActivity in Philadelphia called “Succeeding with Capital Financing in the Face of Economic Turmoil” at 10:45 a.m. on Thursday, April 30th in the Philadelphia Ballroom North. I look forward to answering additional questions there or if your members have any questions, I may be reached as listed below:

Nikolai J. Sklaroff, Managing Director and Head of Cultural Institution Investment Banking,
Loop Capital Markets LLC. (888) 294-8898 or nikolais@loopcap.com