Tortoise QuickTake
Social Infrastructure Podcast

Dec. 19, 2019

Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, Tortoise provides a timely update on trending topics in the market.

Jeremy Goff: Welcome to the Tortoise Social Infrastructure platform update podcast. I'm Jeremy Goff and I'm joined by my partner David Sifford. Together we manage Tortoise's social infrastructure platform. In light of recent asset markdowns across the platform, and the subsequent NAV decrease in the interval fund, the Tortoise Tax-Advantaged Social Infrastructure Fund (TSIFX), we thought it might be helpful to share some additional color on certain holdings and discuss, in detail, what's driving the recent moves, our process for remediating impairments in the portfolio and what our expectations are moving forward as it relates to those specific deals and the overall portfolio.

I'd like to start the conversation by reiterating our conviction in these types of investments as well as our belief that the systemic environment around these assets remains the same. The impairments are a natural part of high-yield investing, and are specifically related to operational issues at the asset level that we are in the process of remediating. The macro-oriented trends that have led us to this opportunity remain consistent and strong in our opinion. We expect that, over time, we will experience various issues in the portfolio and are prepared, through both the structuring of the investments and our team's experience, to work through the issues and attain the best possible outcome for our investors.

Digging into the most recent markdowns, we will start with a discussion around the deals influencing the most recent move in the NAV of the interval fund. Over the course of the last week, we have experienced valuation changes in connection with two of our relationships in the charter school and senior living space. In both cases, the impaired investments are tied to a single management company. Collectively, the charter school and senior living assets are referred to as Championship and Affinity, respectively. With that Dave, I'll let you dive into the specifics and the options that we have available moving forward with these assets.

David Sifford: We currently have investment in two assets, a K-8 school and a high school in south Florida, which are both supervised by a common management company. There are a total of five schools under that management company that were in operation going into the 2019/2020 school year. During the current school year, that particular management company has come under some financial strain. One of the schools, which is not on the Tortoise platform, received a notification that its charter had been revoked due to security concerns. That was the beginning of the financial strain, as the management company was no longer receiving payment for service due to a lack of operation. Currently, that revocation is under appeal and there is a strong belief that the charter will be reinstated during the current school year.

Regarding the investments that are on the Tortoise platform, the most concerning situation relates to the high school, which received a school grade of F from the Florida Department of Education for the 2018/2019 school year, down from a D in the previous year. Bear in mind, this is in a failing school district where a large portion of the schools also rate as an F. That grade led to a decline in enrollment and subsequently financial struggles, culminating with the obligation on the Tortoise-related debt going unpaid. The high school is currently under a school board approved improvement plan to raise the school grade above an F. Typically, the outcome from that results in increased enrollment, which should assist with the ability to pay on the debt as agreed. The school has already achieved improved enrollment with an increase of more than 25% from the beginning of the school year. That said, there remains a high hurdle in front of them.

We believe that the financial strain across the board with that particular management company has also led to a decision to default on the payments for the K-8 school, although the financials point to the ability to make payments on the debt. The enrollment continues to improve (already up 10% from the prior year) pointing to the ability to pay the debt in the future. That school received a school grade of C compared to a D the prior year, so academically, we have already seen improvement in performance.

Our options going forward are as follows:

The least attractive scenario, which would only be used as a last resort, would be to foreclose and liquidate the collateral. However due to our belief that the area is one in dire need of school choice and alternative educational options, we think that our initial investment thesis will hold. Additionally, the other three schools in the network that are not on the Tortoise platform have received school grades of two B's and one C, up from 2 C's and one D in the previous year. This leads us to believe that the management company continues to show progress and the ability to operate at a higher level than district standards.

Therefore, we are more likely to choose one of the following two options.

1. If we choose to continue the relationship with the current management company, we can restructure the debt with the current obligor to allow time for improvement and a plan to get the debt payments current.

2. If not, as a result of protective covenants, we can use the default to force a management change by leveraging relationships with the authorizer and other area management companies to come in and take over the operation.

We believe that either of these two scenarios could allow for future recapture of value and future payment on the debt.

We also have a portfolio of related debt investments in senior living assets under a common management company and an individual debt investment in an asset that closed in April and July of 2018, respectively, with follow-on investments for the portfolio deal in December of 2018. Those assets are struggling to meet debt payment obligations due to slower than expected ramp-up in occupancy. The first cash payment was due in October, and due to inability to pay, a forbearance was presented and verbally agreed upon to allow for a January refinancing by an outside party. We believe that forbearance will be signed in the upcoming weeks. Additionally, we have a group of debt investments that closed in April of 2018 with land held for development. Each of those sites has been granted a certificate of need, and the obligor is currently awaiting financing to complete the projects for future facilities that lack the ability to cash pay, hence the inability to meet the deferred coupon payments that are due on January 1st. A forbearance has been requested by the obligor, and unless that forbearance is signed by January 1st, a default is looming.

The plan regarding the operating facilities is to receive a signed forbearance and allow them the opportunity to refinance off of the platform by the end of January. If this does not occur, the obligor would then be in violation of the forbearance, and we would have several options:

1. We could reenter into forbearance if refinancing is simply delayed

2. We could restructure the debt to allow for future stabilization and subsequent refinancing at a future date

3. We could replace the management company with another operator, structure a new debt package, and again allowing for future refinance at a later date

4. As always, the last case scenario is foreclose and liquidate

Regarding the land held for development, the following scenarios exist:

1. We could continue to pursue a signed forbearance agreement to allow for future refinancing.

2. We could restructure the current debt to ensure payments are current and time is allowed for seeking construction and takeout financing.

Or 3. We could foreclose on the asset which includes the certificate of need and then one of the two following options:

> 1. Find an alternative operator, structure a new debt package and allow them to seek construction financing and takeout financing.

2. Liquidate the collateral and sell both the land and the certificate of need that is tied to those individual assets.

Jeremy Goff: Thanks Dave. can you touch on how the rest of the portfolio is operating?

David Sifford: Aside from investments in the two struggling relationships, the platform's overall portfolio is operating quite well. We maintain an internal watch list, which basically demonstrates a green, yellow, red approach. Aside from these two aforementioned assets, we currently have two additional assets labeled as red, five relationships labeled as yellow, and 15 assets which are labeled as green, operating as agreed. This demonstrates the current quality of our portfolio at large. As Jeremy mentioned earlier, given TSIFX employs a high yield strategy, we will likely always have investments in some assets that fall within the red and yellow categories. Our job is to limit that number and work through those investments that find themselves in that position.

Jeremy Goff: Thanks Dave. I just want to reiterate, we maintain a positive outlook for the platform's current and future investments. We are, and will continue to be, focused on our long-term targeted outcomes for each of our vehicles and the platform as a whole. We currently have a robust pipeline of approximately $850 million in opportunities and continue to see that number grow daily. We added a fourth originator this year with two now dedicated to the education sector. We have originated 12 deals year-to-date for a total of $138 million across all three sectors: education, senior living and project finance. In closing I'd like to thank everyone for their interest in our platform and for taking the time to listen to the podcast.

Thank you for joining us. And stay tuned for our next cast. Have topics you want covered or other feedback to share? Write us at info@tortoiseadvisors.com.

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