ARIZONA PUBLIC SCHOOL CREDIT ENHANCEMENT PROGRAM

Program and Funding Overview

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RBC Capital Markets

ARIZONA PUBLIC SCHOOL CREDIT ENHANCEMENT PROGRAM OVERVIEW

- The Arizona Public School Credit Enhancement Program (the "Program") was developed to meet Governor Ducey's commitment to broadening access to in-demand, high-performing schools for all K-12 students by helping Arizona's best public schools replicate and expand.

- The Program achieves the Governor's commitment for expanding such high quality schools by:
  - Providing access to lower cost facility capital through the credit enhancement of qualified district and charter school bonds.
  - Targeting areas of exhibited demand for high quality seats.
  - Targeting areas of need for high quality educational opportunities.

- The Program lowers borrowing costs by creating a Credit Enhancement Fund of $100MM that will guarantee the scheduled principal and interest payments on school bonds covered under the program.
  - An enhanced rating based on the Program guarantee will be obtained at the time of each school financing, with such rating being higher than that of the individual underlying school borrower.
  - The enhanced credit rating will result in lowered borrowing costs for the school, thereby producing a financial benefit.

- The Arizona Public School Credit Enhancement Program is similar in concept to enhancement programs used to support public school borrowings in several other Western states (e.g. Colorado, Texas, Utah).

REDUCED BORROWING COSTS WILL PROMOTE STUDENT ACCESS TO HIGH QUALITY EDUCATIONAL OPPORTUNITIES

PROGRAM DETAILS AND FUNDING

- Public schools commonly issue bonds to finance school construction. The interest rates they pay depend on investors' assessments of the risks associated with the bonds and vary from school to school.

- The Program will reduce borrowing costs by making bonds less risky for investors by ensuring that bonds will be repaid even if the school is not able to make a payment. The Program creates an "insurance fund" for the purpose of repaying participating public schools' principal and interest payments on debt-financing in the event a school defaults. *The State of Arizona is not liable for any school default and the Program is not expected to have any impact on the State's credit rating.*

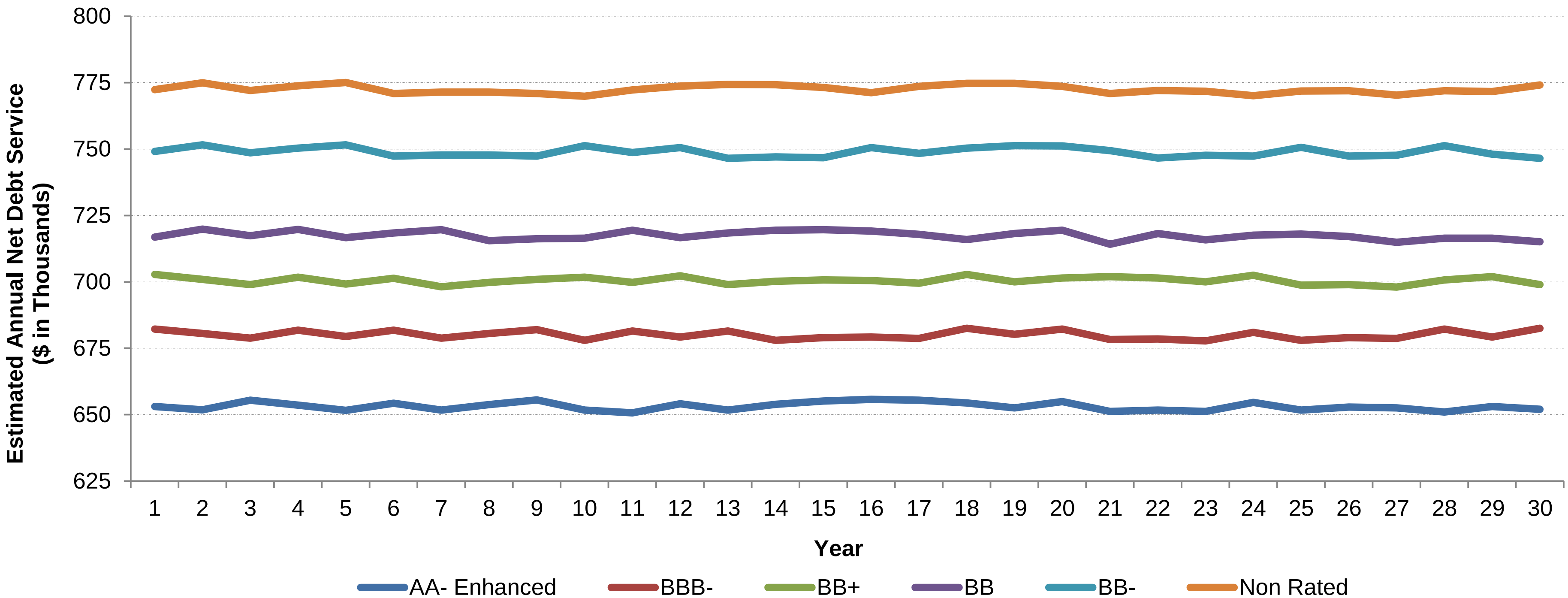
- The Program is funded at a fixed and limited amount of $100 million -- derived from two sources: a) $20 million previously appropriated for this purpose and b) an $80 million investment of public funds by the State Treasurer pursuant to statute. It is expected that the $100 million in the Fund will enhance approximately $350 million of bonds issued by public schools' participating in this program.

- The Public School Credit Enhancement Program has received preliminary indication from Standard & Poor's that bonds issued by eligible schools would be assigned a credit rating of "AA-", higher than the rating of any Arizona charter school and of a number of district schools.
  - *The savings in interest costs could either serve as a benefit to the taxpayers (district general obligation bonds) or be reallocated for school instructional or operational expenses, such as classroom-related expenses or soft capital (charter schools).*

State Program Backing to Reduce Borrower Costs for Eligible Borrowers/Facilities

POTENTIAL ENHANCEMENT BENEFIT

- The table below exhibits projected differences in annual bond payments for a $10MM financing between a AA- enhanced rated issue and issues of various credit ratings typical for Arizona charter schools.
  - Payments are based on estimated current market rates as of mid-November; results may differ based on actual market conditions at the time of issuance of any enhanced bonds.
  - Potential net benefits may increase with higher levels of interest rates.



Source: RBC Capital Markets

Benefits/Savings Are Generated From Lower Interest Rates for Higher Rated Enhanced Bonds

PROGRAM ADMINISTRATION

- The Credit Enhancement Eligibility Board is responsible for managing and directing the Arizona Public School Credit Enhancement Program.

- Primary duties of the Credit Enhancement Eligibility Board are to:
  - Adopt policies and procedures governing the operation of the Program.
  - Develop and administer an application process to determine eligible borrowers.
  - Review and approve eligible borrowers as beneficiaries under the Program.
  - Manage the Credit Enhancement Fund.

- The Governor's Office of Education will provide administrative support to the Board, including reviewing and evaluating applications for credit enhancement.
  - The Board may also engage advisors or consultants, as necessary, to assist in provision of the services of the Program.

- The State Treasurer is responsible for holding and investing monies in the Credit Enhancement Fund pursuant to statute and at the direction of the Board.

REDUCED BORROWING COSTS WILL PROMOTE STUDENT ACCESS TO HIGH QUALITY EDUCATIONAL OPPORTUNITES

PROGRAM ELIGIBILITY FOR PUBLIC SCHOOLS

- The decision to accept or reject a school's application for the Credit Enhancement Program will be made by the Board. The application form and process will be designed by the Board based on general guidelines and requirements established in law.
- To be eligible to participate in the Credit Enhancement Program, schools must be admitted as a member school in an Achievement District. The eligibility criteria for this purpose include:
  - The assignment of a letter grade of "A", or an equivalent successor classification, pursuant to section 15-241.
  - Proven instructional strategies and curricula that demonstrate high academic outcomes.
  - Verifiable enrollment demand, including the placement of prospective pupils on waiting lists.
  - A sound financial plan that contemplates operational costs and future enrollment growth.
  - A commitment to provide technical assistance, including business services, curriculum development and teacher training, to an underperforming school in the State.
- At the time of a school financing, the Board will use various metrics to evaluate applicants for credit enhancement, including:
  - Membership in the Achievement District (per the above requirements).
  - Applicant's financial position, including evaluation of financial metrics such as day's cash on hand, debt service ratio, etc.
  - Terms of the proposed financing.
  - Whether the financing has a fully funded debt service reserve fund (charter schools are required to have a debt service reserve fund to be able to sell bonds).
  - Value of property pledged as collateral.
  - Impact of the proposed financing on the overall enhancement fund credit portfolio (no more than 25 percent of enhanced financings in aggregate may have an underlying credit quality of less than "BB-").

High Performing and High Demand Schools are Eligible

ADDITIONAL PROGRAM DETAILS

- The Credit Enhancement Program will enhance the bonds of eligible district or charter schools by guaranteeing the timely payment of principal and interest on such bonds.
  - Eligible bond structures include revenue bonds for charter schools and general obligation bonds and lease-purchase financings for school districts.

- The Program will be available for financings to:
  - Acquire, construct and equip, renovate, equip, refinance or improve new capital facilities.
  - Renovate and improve existing capital facilities.
  - Refinance existing debt borrowings subject to meeting certain debt service savings thresholds and repayment structures.

- Schools approved for credit enhancement are required to pay an annual program participation fee as determined by the Board.
  - Charter schools are required by statute to pay an annual participation fee equal to at least .25% of the school's total outstanding principal that is enhanced through the Program.
  - Program participation fees for district schools, if any, are as determined by the Board.

REDUCED BORROWING COSTS WILL PROMOTE STUDENT ACCESS TO HIGH QUALITY EDUCATIONAL OPPORTUNITIES

ENHANCEMENT FUND SOURCES AND USES

- The Program utilizes the following resources and revenues to support its guarantees and activities which will be deposited in accounts and subaccounts within the Enhancement Fund:
  - Initial deposits to the Enhancement Fund, including an amount appropriated by the State legislature ($20MM) and an investment in debt obligations issued by the Board ("Program Funding Obligations") by the State Treasurer ($80MM).
  - Annual participation fees paid by public schools and public charter schools as established by the Board (initially targets an annual fee of at least 0.25% of outstanding guaranteed principal amount for charter schools).
  - Investment income earned on monies in the Program Fund.
  - Repayments of Program monies used, if any, to pay principal and interest on guaranteed financings.
  - Gifts, grants and donations received from any public or private source to carry out the mission of the Program.
  - Any other monies appropriated, distributed by law or pursuant to contracts arising out of a guaranteed financing to the Program.
- Additional monies previously appropriated ($3.9MM) for funding any operating expenses of the Program (which are expected to be limited) and for paying interest on the Board Funding Obligations will be held in a separate account of the Enhancement Fund.
- Monies in the Enhancement Fund may be used for any of the following purposes:
  - By the State Treasurer to make payments of principal and interest on guaranteed financings.
  - By the Board for:
    - Paying costs incurred in operating and managing the Program.
    - Paying one or more bond insurers to provide municipal bond insurance guaranteeing the timely payment of all or a portion of the principal and interest on any guaranteed financing.
    - Paying principal and interest to the State Treasurer on Program Funding Obligations issued by the Board, subject to the terms of the Program.

REDUCED BORROWING COSTS WILL PROMOTE STUDENT ACCESS TO HIGH QUALITY EDUCATIONAL OPPORTUNITIES

PROGRAM MECHANICS

- Initial deposits of State appropriated funds ($20MM) and proceeds of Board Funding Obligations ($80MM) required to be made to the Enhancement Fund prior to initial originations of guaranteed financings
- Guaranteed financings are made as applications are accepted and approved by the Board for public district or charter schools meeting the established criteria
  - Origination of total guaranteed financings are limited to maximum Program leverage ratio of 3.5 to 1
- Program generates recurring revenues from collection of participation fees associated with guaranteed financings and investment earnings on Program Fund balances
  - Excess monies in Enhancement Fund over and above the leverage ratio are used to pay principal and interest to State Treasurer to repay Board Funding Obligations
  - Interest on Board Funding Obligations paid at actual earnings plus 1% once credit guarantee is in place
- Default or delay in payment of principal or interest on a guaranteed financing would be addressed as follows:
  - Initial payments to school bond investors are made from monies in any debt service reserve fund associated with the guaranteed financing
    - A debt service reserve fund is required for any charter school financing or school district lease-purchase financing guaranteed by the Program
    - Notice required to Board and State Treasurer if draws on reserve for guaranteed financing occur
  - Any payments of principal and interest remaining would be made from the Guarantee Account of the Enhancement Fund
    - Notice required to Board and State Treasurer of any expected payment deficiency by Trustee or Paying Agent for guaranteed financing at least 3 business days prior to payment date on guaranteed financing
    - State Treasurer to fund deficiency from Program Fund not less than 2 business days after receipt of notice
  - If a borrower for a guaranteed financing ceases operations or is unable to reimburse the Program for guaranteed payments, the project funded by the guaranteed financing may be seized for re-lease or sale to reimburse the program for some or all of its expended Program funds for such.
  - State funds may also be intercepted for making repayments of any guaranteed funds used to meet a deficiency

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