



**Governor's Office of Strategic
Planning and Budgeting**

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Douglas A. Ducey
Governor

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Director

DATE: October 6, 2020

TO: Credit Enhancement Eligibility Board

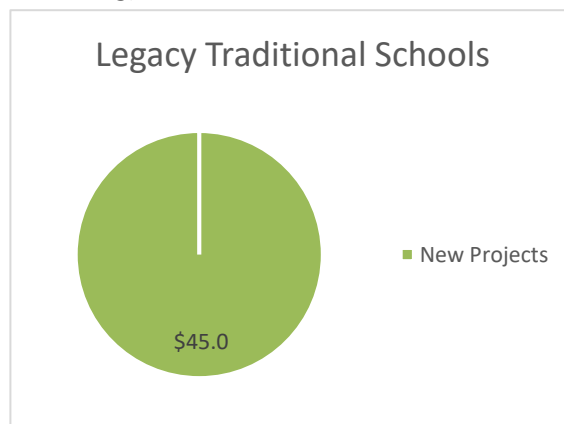
THRU: Matt Gress, Director, Governor's Office of Strategic Planning and Budgeting

FROM: Bryce Haws, Budget Analyst, Governor's Office of Strategic Planning and Budgeting

SUBJECT: Legacy Traditional Schools – Application for the Public School Credit Enhancement Program

Summary of the Request

Legacy Traditional Schools (LTS) has applied for additional participation in the Public School Credit Enhancement Program for up to \$45.0 million in proposed financing. LTS requests enhancement for \$43.5 million to acquire and construct three new campuses and \$1.5 million for costs related to the issuance and startup. The proposed financing will enable LTS to expand capacity by a total of 1,800 seats (*see Impact of Proposed Financing*).



Based on Staff review, Legacy Traditional Schools meets the requirements to qualify for the Public School Credit Enhancement Program.

Recommendation

The following three options are available for the Board to consider regarding Legacy Traditional Schools' application to the Public School Credit Enhancement Program:

- A. Approval of credit enhancement for the full amount of the proposed financing of \$45.0 million.
- B. Approval of credit enhancement for an amount that is less than the full amount of the proposed financing.
- C. Denial of credit enhancement for any portion of the proposed financing.

Approval of credit enhancement of any amount is subject to the applicant's execution of the Terms and Conditions Agreement and Reimbursement Agreement prior to the issuance of a Fund Certificate, which will confirm the guarantee of timely payments of principal and interest on the financing.

Analysis

Applicant Overview

Legacy Traditional Schools operates 17 Arizona charter schools that serve a total of 17,759 students, with a waitlist of 777 students for all Arizona schools. LTS also operates three campuses in Nevada. Most Arizona campuses are in the Phoenix metropolitan area, but there are also locations in Maricopa and Tucson. LTS plans to open three new campuses in Deer Valley, Mesa and Tucson in school year 2021-2022 and projects serving 530 students at each campus (1590 total) in the first year of operation, and 600 students at each campus (1800 total) by school year 2023-2024. The Charter Board approved the replication for the Deer Valley, Mesa and Tucson charters on August 10, 2020.

2020-2021 Legacy Traditional Schools Enrollment¹		
Campus	Enrollment	Waitlist
Avondale	1,289	351
Casa Grande	1,238	98
Chandler	1,172	47
East Mesa	906	7
Gilbert	1,060	0
Glendale	1,123	0
Goodyear	476	11
Laveen	928	0
Maricopa	1,292	18
North Chandler	887	8
Northwest Tucson	1,164	0
Peoria	756	82
Phoenix / N Phoenix ²	1,664	88
Queen Creek	1,284	53
Surprise	1,783	12
West Surprise	738	2
Total	17,759	777

Legacy Traditional Schools was approved by the Credit Enhancement Eligibility Board as an Achievement District School at the October 21, 2019 Credit Enhancement Program Board meeting and has provided verification that Achievement District School requirements continue to be met.

According to the application, Legacy Traditional Schools' approach to student achievement begins with a foundation of fundamental and higher-level thinking skills achieved through a structured curriculum that is consistent within each grade level and sequential throughout the grades. The kindergarten through eighth-grade curriculum is taught using whole group, uninterrupted, teacher-led direct instruction. Language Arts is phonics-based, supporting the curriculum's rigorous focus on reading, writing, mathematics, social studies, and science. The applicant reported that students' average passing scores

¹Enrollment Data Source: ADE School Finance Charter Equalization Reports (CHAR55), September 2020

² LTS-North Phoenix will rent its charter-school facilities for the North Phoenix School from LTS-Phoenix and both schools will operate on the Phoenix Campus. Accordingly, the student enrollment and waitlist data for both schools is aggregated to the combined campus level.

on the 2019 Arizona Merit (AzM2) test were 66% for English Language Arts (ELA) and 61% for Math compared to the statewide averages of 45% for ELA and 43% for Math for all tested grades.

The applicant has reported that for the 2019-2020 school year, 33% of the enrolled population across the Legacy Traditional Schools network of Arizona schools was eligible for free and reduced-price lunch. The following table shows the eligible free and reduced-price lunch populations for each school in the LTS network. Historic rates for LTS have been above 30% of students.

2019-2020 Free and Reduced Priced Lunch Recipients					
School	Enrollment	Free	Reduced	Total	Percentage
Legacy Traditional School - Avondale	1,299	431	149	580	44.65%
Legacy Traditional School - Casa Grande	1,263	480	117	597	47.27%
Legacy Traditional School - Chandler	1,236	102	95	197	15.94%
Legacy Traditional School - East Mesa	841	222	89	311	36.98%
Legacy Traditional School - Gilbert	1,108	95	137	232	20.94%
Legacy Traditional School - Glendale	1,118	252	105	357	31.93%
Legacy Traditional School - Goodyear	379	136	44	180	47.49%
Legacy Traditional School - Laveen	1,060	371	135	506	47.74%
Legacy Traditional School - Maricopa	1,307	208	148	356	27.24%
Legacy Traditional School - North Chandler	897	300	90	390	43.48%
Legacy Traditional School - NW Tucson	1,171	216	155	371	31.68%
Legacy Traditional School - Peoria	689	65	56	121	17.56%
Legacy Traditional School - Phoenix	1,369	546	187	733	53.54%
Legacy Traditional School - Queen Creek	1,319	203	171	374	28.35%
Legacy Traditional School - Surprise	1,903	186	156	342	17.97%
Total	16,959	3,813	1,834	5,647	33.30%

Application Details:

Date Received: 7/7/2020

Date Complete: 8/14/2020

Deadline to Approve/Deny: 10/13/2020

Applicant Contact: Rob Howatt –Chief Financial Officer, Vertex Education

Borrower’s Counsel: Warren Charter Law, PLC

Bond Counsel: Engelman Berger, P.C.

Underwriter: RBC Capital Markets

Bond Issuer: Maricopa County Industrial Development Authority

Impact of the Proposed Financing

Legacy Traditional Schools requests enhancement totaling \$45.0 million in proposed financing for the following purposes:

- 1) \$14.5 million to construct a new campus in Deer Valley, AZ. The new campus will allow LTS to serve 600 students in grades K-5 in the Deer Valley area. The campus will include 21 general instruction classrooms, 4 resource classrooms, a media and computer lab, a stage/music classroom, a commercial kitchen, a shared gymnasium and cafeteria, and associated admin

and related services space. Outdoor amenities will include over 100 onsite parking stalls, 2 dedicated lanes for student drop off and pick up, 1 playground and swing set, covered turf pay area, outdoor basketball court, 4-square play areas, kickball field, and a large general use play field.

- 2) \$14.5 million to construct a new campus in Tucson, AZ. The new campus will allow LTS to serve 600 students in grades K-5 in the East Tucson area. The campus will have the same features as the Deer Valley campus.
- 3) \$14.5 million to construct a new campus in Mesa, AZ. The new campus will allow LTS to serve 600 students in grades K-5 in the Mesa area. The campus will include the same features as the Deer Valley campus.
- 4) \$1.5 million for other costs related to issuance and startup.

The applicant estimates that savings from credit enhancement will total \$ \$19.2 million over the lifetime of the bonds, or about \$547,912 annually, and plans to use those savings to improve operations and add additional seats. The present value of the savings, \$11.1 million, and payment schedule meet program requirements.

Eligibility for Credit Enhancement

A.R.S. § 15-2155 requires that applicants provide proof as an Achievement District School, show sustainability of financial operations, provide information about the financing proposed to be guaranteed, and identify any property being pledged as collateral. Charter school applicants are additionally required to demonstrate experience in operating and managing charter schools and acknowledge that the financing will include a debt service reserve fund that is equal to at least the maximum amount permitted by federal law.

Legacy Traditional Schools' proposed financing meets Board criteria for conditional approval for credit enhancement, and compliance with the Terms and Conditions Agreement and Reimbursement Agreement will ensure that all program requirements are met.

Legacy Traditional Schools has outstanding Series 2013, 2014A, 2015, 2016, 2019AB&C bonds. LTS carries an underlying rating of Ba2 as assessed by Moody's in November 2019, equivalent to a Standard and Poor's BB rating. Series 2019A also carries this rating, plus an additional rating of AA- based upon the rating of the Arizona Public School Credit Enhancement Program. LTS is expected to receive a BB+ underlying rating from S&P this month, though at the time this memo is being prepared the published report is not yet available.

The November 2019 Moody's ratings report highlights Legacy Traditional Schools' large coverage area in a growing metropolitan area and history of strong academic results as credit strengths. The report bases a stable outlook on the expectation that LTS will maintain sufficient enrollment to sustain financial performance providing adequate annual debt service coverage with modest growth of liquidity. The report also lists failure to meet enrollment expectations or additional leverage without significant growth in financial maturity as potential credit risks.

Based on S&P's rating medians for charter schools for FY 2018, Legacy Traditional Schools has a waitlist as a percentage of enrollment that is below BB rated schools and days cash on hand in line with BB rated

schools. However, LTS's debt per student is higher than S&P's FY 2018 charter school medians for similarly rated charter schools. LTS's debt service coverage ratio is above the 1.10 benchmark.

(Please see Appendix A for the Board-contracted Financial Advisor's analysis of Legacy Traditional Schools and program requirements.)

Impact on Credit Enhancement Program

The approval of any individual financing affects the Arizona Public School Credit Enhancement Program's capacity to enhance future financings, compliance with statutory ratios, and potentially the enhanced credit rating assigned to current and future financings.

A.R.S. § 15-2155 requires that the Board ensure that the program leverage ratio, which is the ratio of the principal amount of guaranteed financings to the amount on deposit in the Arizona Public School Credit Enhancement Fund, not exceed 3.5 to 1. If the full amount of the proposed financing is approved for credit enhancement, the program will remain in compliance with the maximum program leverage ratio.

Most charter schools with underlying credit ratings are rated BB, BB+, BBB-, or BBB. However, if S&P fails to reassess the applicant's underlying credit rating as BB- or higher, the financing would count against the maximum 25% of the aggregate principal amount of guaranteed financings, or \$87.5 million, that may have an underlying credit rating of B+ or lower. Legacy Traditional Schools carries an underlying rating of Ba2 from Moody's (equivalent to S&P BB rating) which was published on November 13, 2019 and confirmed in a periodic review on August 7, 2020 and will not count against the 25% trigger since its latest underlying rating is above BB-.

The higher the enhanced credit rating assigned to guaranteed financings, the greater the benefit of the program to participants. The assumptions made by S&P in an initial review of the program included that the program would have approximately 35 participants with an average enhanced financing of \$10 million each. Legacy Traditional Schools' proposed financing is larger than the average size of an enhanced financing assumed in S&P's initial analysis.

If the proposed financing is approved and proceeds as submitted, approximately 12.9% of the program's total capacity will be used to enhance this financing, bringing program usage to 80.0% of the total capacity. Approval of the full \$45.0 million of requested guaranteed financing would result in 23.6% of the program's total enhancement capacity being attributed to Legacy Traditional Schools. The program's credit rating may be adversely affected if any single applicant's share of the enhancement capacity exceeds 35%.

Additional Considerations

Legacy Traditional Schools has certified that no board members, employees, or immediate relatives of board members or employees will benefit from the proposed financing.