State of Arizona
Office of the Governor

Douglas A. Ducey
Governor

Executive Office

DATE: October 18, 2017

TO: Arizona Public School Credit Enhancement Eligibility Board

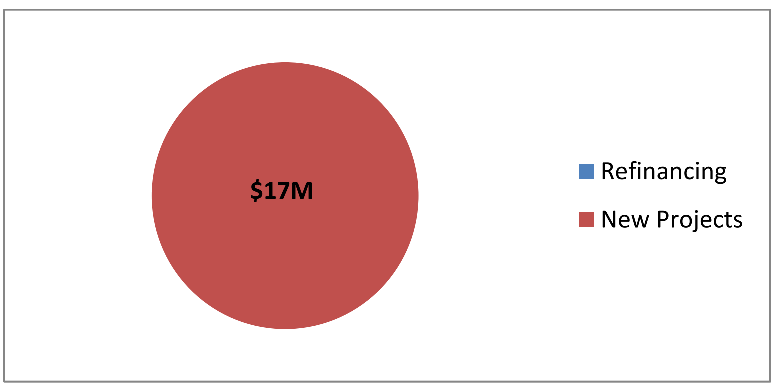
THRU: Dawn Wallace, Senior Advisor for Education, Governor's Office

FROM: Charlie Martin, Budget Manager, Governor's Office of Strategic Planning and Budgeting

SUBJECT: Arizona Agribusiness and Equine Center – Re-Submitted Application for the Public School Credit Enhancement Program

Summary of the Request

Arizona Agribusiness and Equine Center (AAEC) has applied for participation in the Public School Credit Enhancement Program with a $17 million proposed financing. In summary, the $17 million will be used to establish a new campus in Mesa and to expand the Estrella Mountain campus in Avondale to increase enrollment capacity by about 560 students (see Impact of Proposed Financing). AAEC was approved as an Achievement District school and was previously approved to credit enhancement in April 2017, but has not yet issued bonds that are guaranteed by the Arizona Public School Credit Enhancement Program.



Based on staff review, AAEC meets the requirements to qualify for conditional approval for the Public School Credit Enhancement Program.

Recommendation

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

1. Approval of credit enhancement for the full amount of the proposed financing of $17 million.
2. Approval of credit enhancement for an amount that is less than the full amount of the proposed financing
3. Denial of credit enhancement for any portion of the proposed financing

Note: Final Board approval of credit enhancement 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

AAEC operates five charter schools: Phoenix (South Mountain Campus), Paradise Valley, Mesa (Red Mountain Campus), Avondale (Estrella Mountain Campus), and Prescott Valley. The locations currently enroll a total of 1,662 students. AAEC has indicated that the curriculum is "college preparatory with an agribusiness and science emphasis" and that students are able to attend classes at adjacent community colleges at no cost to the student. AAEC provided 2015, 2016, and 2017 AzMERIT test scores to demonstrate high academic outcomes.

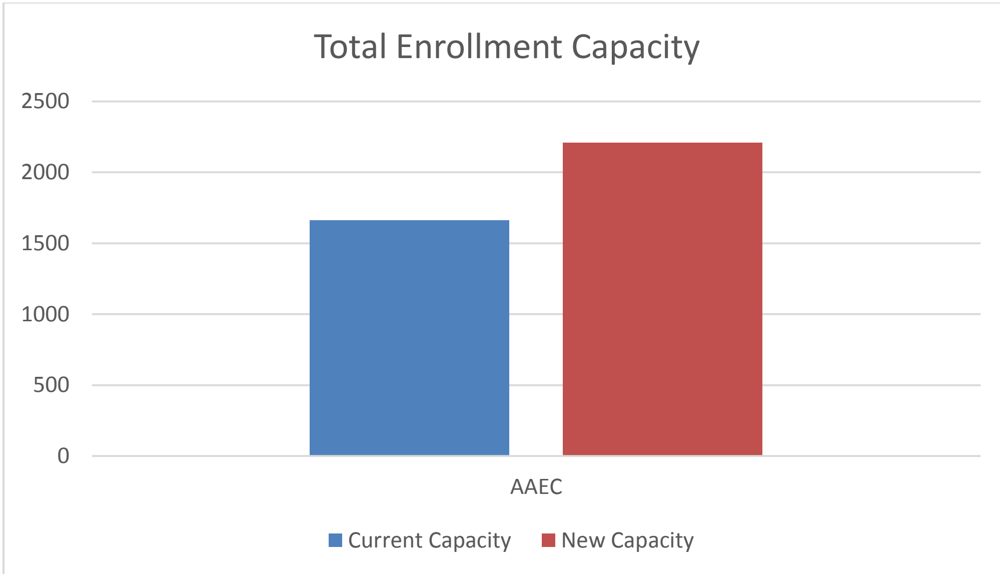
Application Details:

Date Received: 9/29/2017
Date Complete: 10/13/2017
Deadline to Approve/Deny: 12/12/2017

Applicant Contact: Suzanne Drakes, Assistant Executive Director
Borrower's Counsel: Quarles & Brady
Bond Counsel: Kutak Rock
Underwriter: Robert W. Baird & Co
Bond Issuer: Arizona Industrial Development Authority

Impact of the Proposed Financing

AAEC projects that the proposed financing will expand capacity by 560 students. The proceeds will be used to establish a new campus in Mesa and expand the Estrella Mountain campus located in Avondale. About $7.5 million will be used to build the new campus in Mesa, including purchasing and renovating an existing building to accommodate 17 classrooms, 2 labs, and related facilities. The new Mesa campus will serve about 260 students. About $9.4 million will be used to expand the Estrella Mountain campus to accommodate an additional 300 students.



Eligibility for Credit Enhancement

ARS §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.

AAEC's 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. Rating agency Standard and Poor's assigned a BB+ underlying rating to the proposed financing in August. This is the 12th highest credit rating and is considered to be an investment grade rating. The majority of charter schools that have an underlying credit rating are rated BB, BB+, BBB-, or BBB.

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.

If the proposed financing is approved as submitted, approximately 5% of the program's total capacity will be used to enhance this financing.

ARS §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. It also requires that, upon the guarantee of 10 enhanced financings, not more than 25% of the aggregate principal amount of guaranteed financings have an underlying, or unenhanced, credit rating of B+ or lower. 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. While the Board will have not yet approved 10 financings, the applicant has received an underlying credit rating of BB- or higher for the proposed financing and should not negatively affect compliance with the second ratio.

The Board should also consider the impact of approving the proposed financing on the enhanced credit rating assigned to financings. The higher the enhanced credit rating assigned to guaranteed financings, the greater the benefit of the program to participants. The assumptions made by rating agency Standard and Poor's 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.

While the applicant's proposed financing is significantly larger than the average financing assumed in the initial rating analysis, RBC Capital Markets had previously advised as the financial advisor to the Board in the initial rating analysis, that enhancing the full amount would not have a negative impact on the enhanced credit rating assigned to program participants based on size of the borrowing alone. However, RBC also advised that the program needs to enhance a total of ten financings and, since the program has a total capacity of $350 million, any enhancement in excess of $35 million would have to be offset by future enhancements of less than $35 million in order to enhance ten total financings. RBC has not been requested to review and has not reviewed the applicant and no opinion of RBC is expressed regarding the credit or financial quality of the applicant or its application or any impact on the credit rating of the Program.

<u>Additional Considerations</u>

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