



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: American Leadership Academy, Inc. – Application for the Public School Credit Enhancement Program

Summary of the Request

American Leadership Academy, Inc. (ALA) has applied as an Achievement District School and for participation in the Public School Credit Enhancement Program with a \$55 million proposed financing. In summary, ALA requests enhancement for \$55 million in new debt that will be used to purchase existing, currently-leased facilities and expand capacity. The proposed financing will enable ALA to serve an additional 840 students (see Impact of Proposed Financing).

Based on staff review, ALA meets the requirements to qualify as an Achievement District School and for conditional approval for the Public School Credit Enhancement Program.

Recommendation

The Board has the following two options regarding ALA's application as an Achievement District School:

1. Approval as an Achievement District School (**Staff recommendation**).
2. Denial of the application to qualify as an Achievement District School.

If the Board does not approve the Achievement District application, ALA is not eligible for the Public School Credit Enhancement Program. If the Board approves the application, the following three options are available for the Board to consider:

1. Approval of credit enhancement for the full amount of the proposed financing of \$55 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

In 2016-2017, ALA enrolled over 6,000 students at 8 campuses in Gilbert, Mesa, Queen Creek, San Tan Valley, and Anthem. ALA has indicated that its mission is to “provide the best educational experience to as many students as possible in a moral and wholesome environment” and that it uses a traditional education model with an emphasis on rigor in core subjects, personal leadership, and a full complement of extracurricular activities. ALA has provided AzMerit test scores to demonstrate high academic outcomes.

Application Details:

Date Received: 8/11/2017

Date Complete: 9/12/2017

Deadline to Approve/Deny: 11/11/2016

Applicant Contact: Bob Plowman, CFO

Borrower’s Counsel: Brian Holmes, Holmes Law, PLC

Bond Counsel: Dane Fernandes, Kutak Rock, LLP

Underwriter: Paula Permenter, BB&T Capital Markets

Bond Issuer: The Industrial Development Authority of the County of Pima

Achievement District Qualification

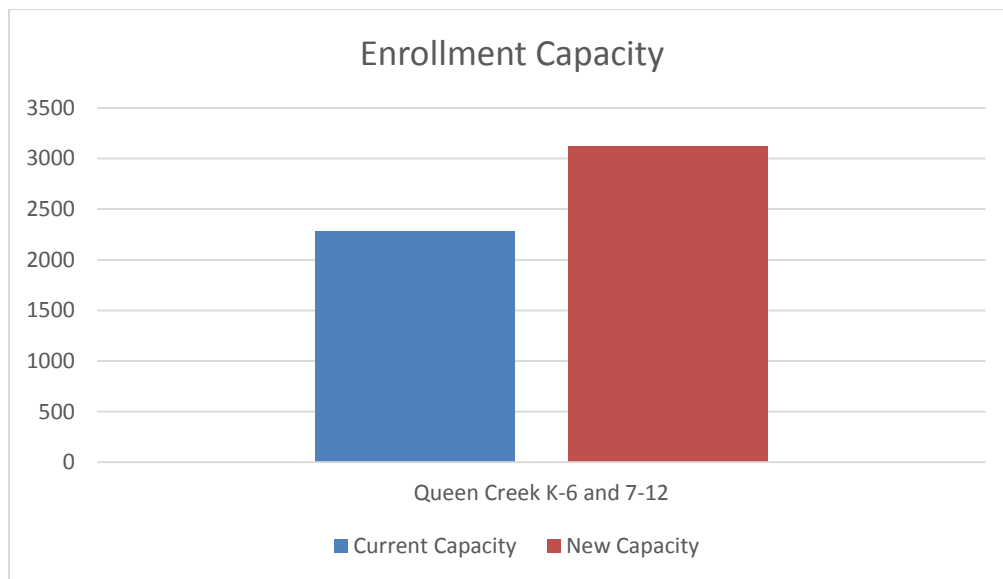
ARS §15-2141 establishes criteria that an applicant must meet to qualify as an Achievement District School. Based on the review of documents provided by ALA in their application, ALA has met the criteria established in statute.

Requirement	Status
Assigned a letter grade of A, or an equivalent successor classification	Verified
Proven instructional strategies and curricula that demonstrate high academic outcomes	Materials Provided
Verifiable enrollment demand, including the placement of prospective pupils on a waiting list	Attestation
Sound financial plan that contemplates operational costs and future enrollment growth	Financial Documents
Commitment to provide technical assistance to an underperforming school	Letter Submitted

At the time of application, ALA reported a wait list of 3,064 potential students across all locations. ALA calculates its wait list based on “expressed intent to enroll,” which includes applications, correspondence with the school registrar or ALA administrators, and communications platforms for parent outreach. Additionally, ALA has partnered with Academy Del Sol, an underperforming charter school in Tucson, to share best practices in the areas of business services, curriculum development, and teacher training. The percentage of students that qualify for free or reduced-price lunch at ALA’s schools ranges from 19.71% to 58.37%. At the Queen Creek K-6 campus, 19.71% of students qualify for free or reduced-price lunch, and at the Queen Creek 7-12 campus, 24.35% of students qualify for free or reduced-price lunch.

Impact of the Proposed Financing

ALA anticipates that the proposed financing will expand student capacity by 840 students. The financing includes \$55 million in new debt to purchase existing K-6 and 7-12 Queen Creek campuses, construct a new building that will include 24 classrooms, and renovate and expand existing facilities to provide space for STEM programs, electives, and extracurricular activities. ALA currently leases the campus facilities and the existing lease contains the option to purchase the property.



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.

ALA’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. ALA does not have an outstanding underlying credit rating. ALA has indicated that it will pledge the gross revenues from all campuses to repay the proposed financing. Staff

estimates that the underlying credit rating will be in the low BB or high B range. Compared to S&P's rating medians for charter schools, ALA has a large scope of operations that is in line with higher-rated charter schools, but ALA will also have relatively higher debt levels, lower cash reserves, and narrower operating margins compared to the medians for higher-rated charter schools. 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 16% of the program's total capacity will be used to enhance the 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, staff cannot be certain whether the applicant will have an underlying credit rating of BB- or higher. If the applicant fails to obtain an underlying credit rating of BB- or higher, the financing would count against the maximum 25% of the aggregate principal amount of guaranteed financings that may have an underlying credit rating of B+ or lower.

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.

Additional Considerations

ALA has disclosed that an employee, Glenn Way, is the partial owner or manager of companies that own the facilities that ALA plans purchase with the proceeds of the proposed financing. ALA currently leases the facilities with an option to purchase. The facilities are located at 19843 E Chandler Heights Road, 23908 South Hawes Road, and 19935 East Chandler Heights Road and the specific companies with which Mr. Way is associated are listed in ALA's application.