



STATE OF ARIZONA
OFFICE OF THE GOVERNOR

DOUGLAS A. DUCEY
GOVERNOR

EXECUTIVE OFFICE

DATE: December 7, 2017

TO: Credit Enhancement Eligibility Board

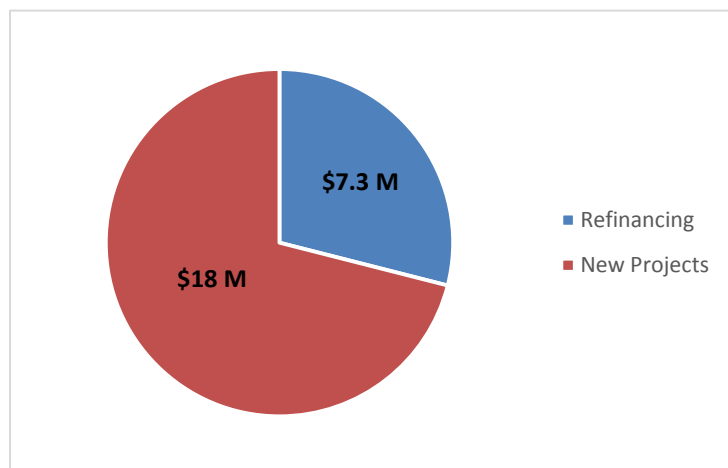
THRU: Dawn Wallace, Senior Advisor for Education, Governor's Office

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

SUBJECT: Academy of Math and Science – Application for the Public School Credit Enhancement Program

Summary of the Request

Academy of Math and Science (AMS) has applied for participation in the Public School Credit Enhancement Program with a \$25.3 million proposed financing. In summary, \$18.0 million is new debt and \$7.3 million will refinance existing debt. The new debt and savings from refinancing will be used to increase enrollment capacity by 1,400 students (see Impact of Proposed Financing). AMS was approved as an Achievement District school on April 25, 2017 and currently has \$23.5 million of outstanding bonds that are guaranteed by the Arizona Public School Credit Enhancement Program.



Based on staff review, AMS 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 AMS's application to the Public School Credit Enhancement Program:

1. Approval of credit enhancement for the full amount of the proposed financing of \$25.3 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

AMS currently operates four charter schools in Arizona. Two schools are located in Tucson, the Academy of Math and Science (AMS Prince) and Math and Science Success Academy (MASSA), and two schools are located in Phoenix, the Academy of Math and Science Camelback (AMS Camelback) and the Academy of Math and Science Flower (AMS Flower). The four schools have a total enrollment of 2,560 students for the 2017-2018 school year. According to the application, the schools have received numerous awards including: 2016 Arizona Charter School of the Year, National Blue Ribbon Award, EPIC Gold Gain Award, and Education Equality Index recognition. In addition, AMS reports that the schools outperform peers in the same geographic area and peers that serve a similar percentage of students that are eligible for free or reduced-price lunch on the AzMERIT test.

Application Details:

Date Received: 11/9/2017

Date Complete: 11/14/2017

Deadline to Approve/Deny: 1/13/2018

Applicant Contact: Steven Hykes, CFO

Borrower's Counsel: Warren Charter Law

Bond Counsel: Greenberg Traurig

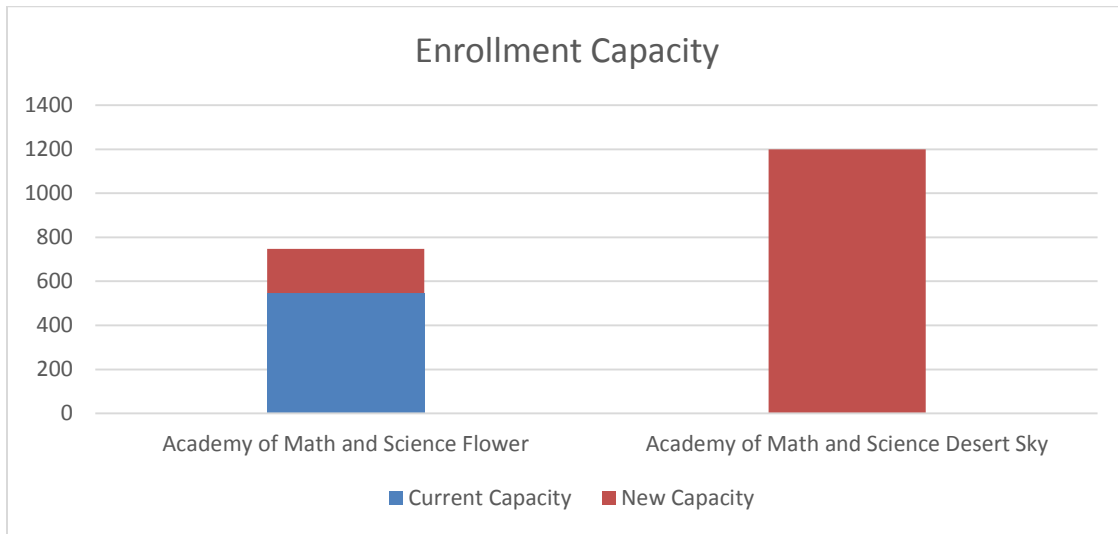
Underwriter: RBC Capital Markets, LLC

Bond Issuer: Arizona Industrial Development Authority

Impact of the Proposed Financing

AMS anticipates that the proposed financing will expand student capacity by 1,400 seats. The financing includes \$18.0 million in new debt that will be used to purchase 10 acres of land located at 59th Avenue and McDowell Road in Phoenix and build a 75,000 square foot school that will include 48 classrooms. The new school, Academy of Math and Science Desert Sky, will serve 1,200 students and AMS estimates that 95% of the student population will qualify for free or reduced-price lunch. The proposed financing also includes \$7.3 million to refinance existing debt related to the AMS Flower campus. AMS estimates

that the refinancing will save \$50,000 per year and has indicated that the savings will be used to build eight new classrooms that will enable AMS Flower to serve an additional 200 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.

AMS’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. In June, AMS was assigned an underlying credit rating of BB by S&P. This is the 12th highest credit rating and is two rating-notches below what 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. Based on S&P’s rating medians for charter schools, AMS has a large scope of operations, significant enrollment demand, and healthy operating margins that are in line with higher-rated charter schools, but has higher debt levels compared to higher-rated charter schools. The June 2017 rating report from S&P indicated that AMS has a “problematic governance structure despite the organization’s effective management and governance track record” and also noted that S&P “could consider a negative rating action if any conflicts of interest bring about any issues either on the enterprise profile or financially.”

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 7% of the program's total capacity will be used to enhance this financing and approximately 14% of the program's total capacity will be used to enhance AMS financings.

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 not have approved 10 financings, the applicant is expected to have a credit rating of BB- or higher 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.

Additional Considerations

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