



Governor’s Office of

Strategic Planning and Budgeting

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Douglas A. Ducey
Governor

Matt Gress
Director

DATE: October 2, 2019

TO: Credit Enhancement Eligibility Board

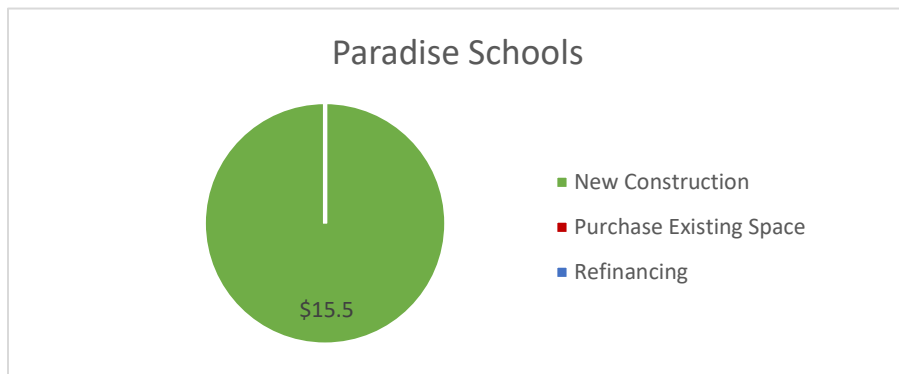
THRU: Matt Gress, Director, Governor’s Office of Strategic Planning and Budgeting

FROM: Sarah Giles, Senior Budget Analyst, Governor’s Office of Strategic Planning and Budgeting

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

Summary of the Request

Paradise Honors High School (PHHS) has applied as an Achievement District School and for participation in the Public School Credit Enhancement Program for up to \$15.5 million in proposed financing. PHHS is requesting \$15.5 million in new debt for enhancement, including: \$13.8 million for new construction to increase enrollment capacity and \$1.7 million for costs related to the debt issuance. The proposed financing will enable PHHS to serve an additional 200 students (see Impact of Proposed Financing).



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

Recommendation

The Board has at least the following two options regarding PHHS’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, PHHS is not eligible for the Public School Credit Enhancement Program. If the Board approves the Achievement District application, the following three options are available for the Board to consider:

- A. Approval of credit enhancement for the full amount of the proposed financing of \$15.5 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

Paragon Management (doing business as Paradise Schools) is the charter holder for PHHS which opened in 2008. PHHS enrolled 840 students in grades 9-12 in school year 2019-2020 with a waitlist of 2 students. Paradise Schools also operates Paradise Honors Elementary School (PHES) which opened in 2003, both in Surprise, Arizona. PHES is authorized to serve kindergarten through eighth grade and operates both an elementary school campus and middle school campus. PHES enrolled 1,944 students in school year 2019-2020 with a waitlist of 298 students. PHES eighth graders are automatically enrolled in PHHS and between 75%-80% of those eligible to enroll at PHHS choose PHHS for high school.

According to the application, PHHS is a Professional Learning Community that utilizes a collaborative, team-based approach to improve both student academic performance and teaching skills. PHHS also employs the Response to Intervention approach and formative assessments to assess learning in real time. The applicant reports that PHHS students' passing scores on the 2018 AzMERIT test were 53% for English Language Arts and 54% for Math compared to the statewide average of 41% in both subjects. PHHS also achieved a 96% Graduation Rate and a 94% Career Readiness Rating.

While both campuses were A-rated in school year 2017-2018, the Arizona Department of Education identified PHHS for Targeted Support and Improvement based on academic performance of its special needs population. Due to this rating, the applicant does not meet the Arizona State Board for Charter School's Academic Performance Framework standards. The applicant notes changes to curriculum and instructional strategies following a comprehensive needs assessment completed in Spring 2019 to enable the special needs population to achieve proficiency. The applicant expects to exit Targeted Support and Improvement status upon conclusion of school year 2019-2020.

Application Details:

Date Received: 7/19/2019

Date Complete: 9/12/2019

Deadline to Approve/Deny: 11/11/2019

Applicant Contact: Dan Bigler, Director of Finance

Borrower's Counsel: Warren Charter Law, PLC

Bond Counsel: Engelman Berger, P.C.

Underwriter: RBC Capital Markets, LLC

Bond Issuer: Maricopa IDA

Achievement District Qualification

A.R.S. §15-2141 establishes criteria that an applicant must meet to qualify as an Achievement District

School. Based on the review of documents provided by PHHS in their application, Staff believes PHHS has met the criteria established in statute.

Requirement	Status
Assigned a letter grade of A, or an equivalent successor classification	Verified for school year 2017-2018
Proven instructional strategies and curricula that demonstrate high academic outcomes	Materials Provided; Applicant is identified for Targeted Support and Improvement status
Verifiable enrollment demand, including the placement of prospective pupils on a waiting list	Attestation of 2 students on waitlist at PHHS and 298 students at PHES
Sound financial plan that contemplates operational costs and future enrollment growth	Financial Documents
Commitment to provide technical assistance to an underperforming school	Partnership with EAGLE College Prep - Mesa

At the time of application, PHHS reported a wait list of 2 potential students based on expressed intent to enroll at the high school campus and 226 eighth graders who are eligible to enroll at the high school in school year 2020-2021. Additionally, there are 61 students on the eighth grade waitlist, which is the basis of the applicant’s freshman enrollment forecast of 287 seats next year compared to the current capacity of 240 seats.

PHHS has partnered with EAGLE College Prep - Mesa, an underperforming charter school, to assist in the areas of teacher coaching and professional development.

At PHHS, 18% of students qualify for free or reduced-price lunch in school year 2018-2019 compared to 43% of high school students in the Dysart Unified School District, also in Surprise.

Impact of the Proposed Financing

PHHS anticipates that the proposed financing will increase student capacity by 200 seats. The proposed financing includes \$1.2 million purchase to a 10-acre parcel of land adjacent to the middle school-high school campus to create a parking lot and new play-practice fields. An additional \$12.6 million will be used to construct and equip an additional 14,000 square feet of classroom and academic space at the high school campus. The additional space will include 12 classrooms, a performing arts auditorium, and other performing arts facilities. The parking lot and practice field construction is projected to be complete by January 2020. The academic and classroom space construction is projected to finish by August 2020. The proposed financing also includes \$1.7 million in other costs related to issuance of this debt. The applicant projects a savings of \$180,000 to \$200,000 annually as a result of credit enhancement which will remain unbudgeted to provide a buffer to ensure the applicant meets new debt service requirements and bond covenants.

The applicant notes that without Credit Enhancement, PHHS would not be able to afford to borrow sufficient funding to acquire the land and construct additional academic and extracurricular space.

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.

Paradise 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.

In September 2019, S&P reaffirmed a BB+/Stable rating to Paradise Schools' currently outstanding Series 2016 Education Revenue Bonds. The S&P rating notes weak liquidity and high maximum annual debt service as a portion of total revenues in Fiscal Year (FY) 2018, but improving debt service coverage across fiscal years, growing enrollment demand and consistent operating surpluses.

Compared to the FY 2018 S&P Charter School Sector Medians, Paradise Schools' projected enrollment of 2,755 is larger than higher rated BBB+/BBB rated charter schools at 2,354, but waitlist as a percentage of enrollment is closer to that of a BB+ rated charter school (Paradise Schools: 18.4% compared to FY 2018 Median: 18.5%). Paradise Schools' projected days cash-on-hand of 49 days in school year 2018-2019 is closer to that of a B+/B/B- rated charter school at 53 days. Additionally, projected school year 2018-2019 lease-adjusted maximum annual debt coverage is greater than the benchmark of 1.10x.

(Please see Appendix A for the Board's Financial Advisor's analysis of Paradise 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.

If the proposed financing is approved as submitted, approximately 4.4% of the program's total capacity will be used to enhance this financing, bringing total program usage to 51.6%.

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.

A.R.S. §15-2155 also requires that upon the guarantee of 10 enhanced financings, not more than 25% of the aggregate principal amount of guaranteed financings, or \$87.5 million, may have an underlying credit rating of B+ or lower. Most charter schools with underlying credit ratings are rated BB, BB+, BBB-, or BBB. While the Board has only approved nine financings to six different borrowers, PHHES would not count against the 25% as it is rated a BB+.

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. PHHS's proposed financing is slightly larger than the average size of an enhanced financing assumed in this initial analysis.

Additional Considerations

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

Evaluation Checklist - Credit Enhancement Application
Paradise Schools

	FY 19 Unaudited	FY 18 Audited	FY 17 Audited
Unqualified Opinion		√	√
Going Concern		√	√
45 Days Unrestricted Cash on Hand from most recent completed fiscal year	√	√	√
OR			
30 Days Unrestricted Cash on Hand in most recently completed fiscal year	N/A	N/A	N/A
AND	N/A	N/A	N/A
Net increase in cash from prior fiscal year	N/A	N/A	N/A
AND			
Unrestricted days cash on hand is projected to increase to 45 days within 2 years based on projections	N/A	N/A	N/A
Debt Service Coverage at 1.1 or higher	√	√	√

Date: 9-6-19

To: Sarah Giles

From: Michele Diamond, Financial Consultant

Subject: Evaluation of Paragon Management, dba Paradise Schools for the Public School Credit Enhancement Program - Financial Sustainability

Conclusion: Paradise Schools has sufficiently demonstrated financial sustainability based on the documents provided and as required by the Board's rules.

Review of Sarah's Memo

I concur but make the following recommendations:

Eligibility for Credit Enhancement Section -2nd paragraph – *“Paradise expects to receive an underlying credit rating in September, but S&P ~~assigned~~ re-affirmed a BB+/Stable rating to Paradise Schools' currently outstanding 2016 Education Revenue Bonds [in March 2019]...”*

Notes to consider:

Note 1: The school's fiscal year 2017 debt service coverage ratio is based on net income **before loss on refunding** note payable. Also, the school's FY 2017 and 2018 DCSR varies from the audited DSCR and S&P's due to different inputs used in the calculation. The school's calculation meets the Board's definition as defined in its Terms and Conditions. This note is informational only and does not change the conclusion above.

Note 2: FY 2017 days cash on hand (DCOH) per school's liquidity statement includes restricted cash of \$346,430 (see audited cash flow statement). Revised DCOH would be 57 days. Revised DCOH is still sufficient per Board's requirement of 45 days of unrestricted cash on hand [for most recent audited financial statement]. This note is informational only and does not change the conclusion above.

Note 3: Updated FY 19 financials (unaudited actuals) dated 8-19-19 have better results than what is indicated in Three Year Financial Projection dated 8-15-19.

Note 4: This memo should be reviewed in conjunction with the Evaluation Checklist