



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

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Douglas A. Ducey
Governor

Matt Gress
Director

DATE: December 11, 2019

TO: Credit Enhancement Eligibility Board

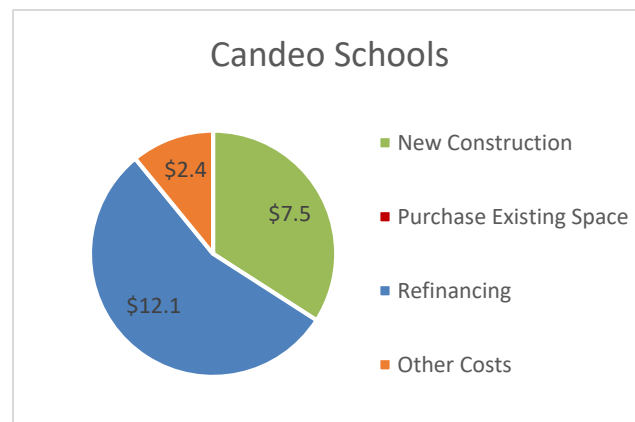
THRU: Matt Gress, Director, Governor's Office of Strategic Planning and Budgeting

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

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

Summary of the Request

Candeo Schools - Peoria has applied as an Achievement District School and for participation in the Public School Credit Enhancement Program for up to \$22.0 million in proposed financing. Candeo Schools requests enhancement for \$12.1 million to refinance existing debt, \$7.5 million to acquire, construct, renovate and equip a new campus, and \$2.4 million for other costs related to the issuance. The proposed financing will enable Candeo Schools to expand capacity by 540 seats (*see Impact of Proposed Financing*).



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

Recommendation

The Board has at least the following two options regarding Candeo Schools' 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, Candeo Schools 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 \$22.0 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

Candeo Schools - Peoria holds a standalone charter with the Arizona State Board for Charter Schools (Charter Board), enrolling 603 students total in grades kindergarten through eight (K-8) in school year 2019-2020 with a waitlist of 420 students. Candeo Schools – Peoria is located in Peoria, Arizona and opened in school year 2007 - 2008. Candeo Schools plans to open a Scottsdale campus in school year 2020-2021 and projects serving 260 students in the first year of operation. The Charter Board approved the Candeo Schools - Scottsdale replication charter at its November 19, 2019 meeting.

According to the application, Candeo Schools' approach to student achievement is based on a classical liberal arts curriculum. The applicant reported that students' average passing scores on the 2019 AzMERIT test were 80% for English Language Arts (ELA) and 82% for Math compared to the statewide averages of 45% for ELA and 44% for Math for grades 3-8. The applicant also noted that Candeo Schools emphasizes content, rigor and relevance utilizing the nationally recognized Core Knowledge curriculum, and has performed in the top 10% of all Arizona schools every year since inception.

Additionally, the applicant reports 3% of students qualified for the federal free or reduced-price lunch program during school year 2019-2020, compared to 46% of elementary students in the Peoria Unified School District in Peoria, and 34% of elementary students in Deer Valley Unified School District serving Peoria, Phoenix, and Glendale in school year 2018-2019, the most recent year data is publically available.

Application Details:

Date Received: 11/6/2019

Date Complete: 11/25/2019

Deadline to Approve/Deny: 1/24/2020

Applicant Contact: Stephanie Musser, Founder & Executive Director, Candeo Schools

Borrower's Counsel: Warren Charter Law, PLC

Bond Counsel: Engelman Berger, P.C.

Underwriter: RBC Capital Markets

Bond Issuer: Arizona 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 Candeo Schools in its application, Staff believes Candeo Schools has met the criteria established in statute.

Requirement	Status
Assigned a letter grade of A, or an equivalent successor classification	Verified for school year 2018-2019
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 of 420 students on waitlist
Sound financial plan that contemplates operational costs and future enrollment growth	Financial Documents
Commitment to provide technical assistance to an underperforming school	Partnership with the Learning Foundation and Performing Arts School - Warner

At the time of application, the Candeo Schools reported a wait list of 420 potential students based on expressed intent to enroll. Additionally, the applicant notes the closest classical education school to the new Scottsdale campus is Great Hearts Academies – Archway Scottsdale which typically maintains a waitlist that is double its enrollment which was 898 students in school year 2018-2019.

Candeo Schools has partnered with the Learning Foundation and Performing Arts School - Warner, a “C” rated charter school in Gilbert, Arizona to provide technical assistance on classroom management, educational strategies, and professional development for Learning Foundation and Performing Arts School - Warner Staff.

Impact of the Proposed Financing

Candeo Schools requests enhancement totaling \$22.0 million in proposed financing for the following purposes:

- 1) \$12.1 million to refund the outstanding Series 2013 bonds which were used to finance a portion of the costs to acquire, renovate, and equip the Candeo Schools - Peoria campus.
- 2) \$7.5 million to acquire, construct, renovate, improve and equip an existing 19,063 square-foot charter school campus with 15 classrooms in Scottsdale for the new Candeo Schools – Scottsdale campus. This project also includes funding to expand the current building structure by an additional 10,860 square-feet and add 11 classrooms. The cost to acquire the campus is \$3.0 million and the cost to build the new classroom space is \$4.5 million.
- 3) \$2.4 million for other costs related to issuance, the debt service reserve fund, and the capitalized interest fund.

The applicant estimates that savings from credit enhancement will total \$2.8 million over the lifetime of the bonds, or about \$50,000 annually, and plans to use those savings to improve operations and add additional seats. The present value of the savings and payment schedule meet program requirements. The applicant notes that without enhancement, Candeo Schools would not be able to qualify for sufficient funding to purchase the new campus and add additional classrooms.

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.

Candeo 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.

Candeo Schools has an outstanding Series 2013 bonds assessed by the rating agency, Standard & Poor's (S&P), in November 2018 as BBB-. S&P reassessed the applicant's underlying credit rating in anticipation of the 2019 bond issuance in December 2019. S&P affirmed the BBB- rating on the 2013 bonds and assigned a BBB- rating to the anticipated Series 2020A and 2020B bond issuance. The S&P ratings report highlights good liquidity, positive operating performance and an average operating margin of 7.7% in the past three audited fiscal years, along with high academic performance. The report also notes a high maximum annual debt service burden composing 19.1% of FY 2018 revenue and high debt per student relative to peers.

The applicant's FY 2018 and FY 2019 audits demonstrate gains on both a cash and accrual basis. Based on S&P's rating medians for charter schools for FY 2018, Candeo Schools' enrollment is smaller than highly rated charter schools, but has a waitlist as a percentage of enrollment that is in line with BBB+/BBB rated schools. Historical and projected days cash on hand are also in line with BBB+/BBB rated schools. Debt per student is closer to BB+ and BB rated schools, and Candeo Schools' debt service coverage ratio is above the 1.10 benchmark.

(Please see Appendix A for the Board-contracted Financial Advisor's analysis of Candeo 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 6.3% of the program's total capacity will be used to enhance this financing, bringing program usage to 67.9% of the total capacity.

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. Candeo Schools would not count against the 25% trigger since its latest underlying rating is BBB-.

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. Candeo Schools' proposed financing is larger than the average size of an enhanced financing assumed in this initial analysis.

Additional Considerations

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

Date: 12-5-19

To: Sarah Giles

From: Michele Diamond, Financial Advisor

Subject: Evaluation of Candeo Schools Financial Sustainability

Conclusion: Candeo 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 with no suggestions.

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

Evaluation Checklist - Credit Enhancement Application
Candeo Schools

	Projected Years	Most Recently Completed Fiscal Year (FY 19)
Unqualified Opinion	n/a	√
No Going Concern	n/a	√
45 Days Unrestricted Cash on Hand from most recently completed fiscal year and all projected years	√	√
OR		
30 Days Unrestricted Cash on Hand in most recently completed fiscal year	N/A	N/A
AND	N/A	N/A
Net increase in cash from prior fiscal year	N/A	N/A
AND	N/A	
Unrestricted days cash on hand is projected to increase to 45 days within 2 years based on projections	N/A	N/A
Debt Service Coverage at 1.1 or higher for most recently completed fiscal year	n/a	√

FY 18 Audited
√
√
n/a
N/A
N/A
N/A
N/A
n/a