



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

1700 West Washington, Suite 600, Phoenix, Arizona 85007
(602) 542-5381 • FAX: (602) 542-0868

**Douglas A. Ducey
Governor**

**Matt Gress
Director**

DATE: TBD

TO: Credit Enhancement Eligibility Board

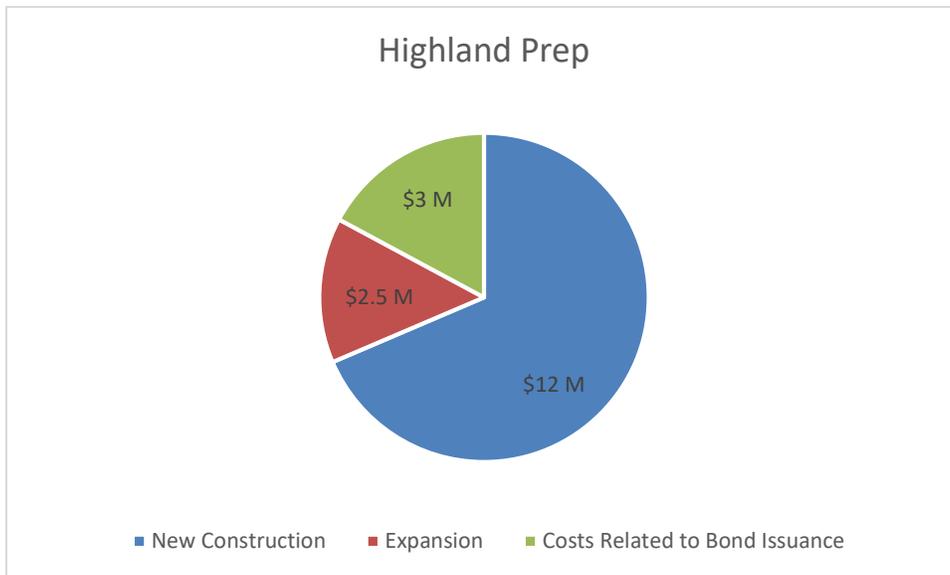
THRU: Matt Gress, Director, Governor’s Office of Strategic Planning and Budgeting

FROM: Alec Eulano, Analyst, Governor’s Office of Strategic Planning and Budgeting

SUBJECT: Highland Prep – Application for the Public School Credit Enhancement Program

Summary of the Request

Highland Prep (HP) has applied in the Public School Credit Enhancement Program for up to \$17.5 million in proposed financing. In summary, HP requests enhancement for \$12 million in new debt that will be used to purchase and construct a new West Campus, \$2.5 million to expand their Surprise Campus, and about \$3 million to cover financing costs. The proposed financing will enable HP to seat an additional 550 students. (see Impact of Proposed Financing).



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

Recommendation

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

- A. Approval of credit enhancement for the full amount of the proposed financing of \$17.5 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

HP holds a standalone charter with the Arizona State Board for Charter Schools and is associated with Madison Highland Prep (MHP) through common board membership (2 out of 5 members). HP is located in Surprise, Arizona and opened in FY 2018. MHP is located in Phoenix and opened in FY 2015. HP enrolled 428 students in grades 9-12 in school year 2020-2021 with a waitlist of 150 students and projects 450 students will be enrolled in school year 2021-2022. At MHP, 463 attends in grades 9-12.

School	Enrollment 2020-2021	Waitlist 2020-2021	FRL %
Highland Prep - Surprise	428	150	40%
Madison Highland Prep	463	148	61%

HP was approved of the Credit Enhancement Eligibility Board as an Achievement School District at the Board’s September 12th, 2019 meeting and has provided verification that Achievement District School requirements continue to be met.

Requirement	Status
Assigned a letter grade of A, or an equivalent successor classification	Per ADE policy, schools in 1 st year of operation are not assigned a letter grade. However, HP would have qualified as an “A” school under the letter grade system in 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 150 students on waitlist at HP
Sound financial plan that contemplates operational costs and future enrollment growth	Financial Documents
Commitment to provide technical assistance to an underperforming school	Partnership with Victory Collegiate Academy

According to the application, HP and MHP are Science, Technology, Engineering and Math (STEM) college-preparatory high schools that emphasize student preparation for success in an increasingly innovation-

driven society and global marketplace. The applicant reports that students' passing scores on the 2019 AzMERIT test were 67% for English Language Arts and 73% for Math compared to the statewide average of 42% in both subjects. The applicant also reports that its Associated Charter, MHP, has passing scores on the 2019 AzMERIT were 65% for English Language Arts and 69% for Math.

Application Details:

Date Received: 1/21/2021

Date Complete: 2/22/2021

Deadline to Approve/Deny: 4/22/2021

Applicant Contact: Erin Wait

Borrower's Counsel: Warren Charter Law, PLC

Bond Counsel: Engelman Berger, P.C.

Underwriter: B.C. Ziegler and Company

Bond Issuer: Maricopa IDA

Impact of the Proposed Financing

Highland Prep requests enhancement totaling \$17.5 million in proposed financing for the following purposes:

- 1) \$12 million to construct a new West Campus located in the Goodyear/Avondale area. The new campus will allow the applicant to serve 450 students in grades 9-12. The new campus is expected to have 20 classrooms (three of which are engineering labs), a gymnasium, a sports field, and track.
- 2) \$2.5 million to expand the Surprise Campus located in Surprise. The expanded campus will allow the applicant to serve an additional 100 students in grades 9-12. The expanded campus will include a larger educational space with additional classroom seats. At the Board's September 2019 meeting, HP was awarded 10.3 million, which primarily allowed the applicant to purchase the Surprise facility it previously leased.
- 3) \$3 million to pay costs related to bond issuance.

The applicant estimates that savings from credit enhancement will total \$7.7 million over the lifetime of the bonds, or about \$221,000 annually, and plans to use those savings to fund increased teacher salaries, supplies, a hired STEM coach, and a facilities manager. The present value of the savings, \$4.8 million and payment schedule meet program requirements.

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.

HP'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. HP has not previously been assigned an underlying credit rating and submitted a letter denoting a financial hardship for obtaining a credit rating on existing facilities bonds.

Based on S&P's rating medians for charter schools for FY 2018, HP has high operating margins and cash reserves that are in line with BB rated charter schools, but is very small and will have high debt levels (nearly double that of other BB rated schools) after accounting for the proposed financing. The applicant provided financial statements for its associated charter, MHP, showing an increase in net assets and cash position in FY 2019 and FY 2018.

The applicant's underwriter believes HP would fall into the BB category given their significant waitlist size as a percentage of enrollment, student retention percentage, 197 days cash-on-hand, and lease-adjusted maximum annual debt coverage greater than the benchmark of 1.10x.

While Staff generally concurs with the applicant's underwriter that HP is not a credit risk to the program, the absence of an underlying credit rating would count against the 25% of guaranteed financings with an underlying credit rating of B+ or lower (*please see Impact on Credit Enhancement Program for more information*). HP would still experience significant cost savings from the enhancement even after accounting for the costs associated with obtaining an underlying credit rating.

(Please see Appendix A for the Board's Financial Advisor's analysis of HP 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. This application would fully consume the remaining capacity of this program if approved.

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 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, or \$87.5 million, that may have an underlying credit rating of B+ or lower. To date, the Board has approved fourteen financings to 10 different borrowers. Of those financings, only two counted against the \$87.5 million cap: Vista College Prep at \$10.5 million and HP 2019 at \$10.3 million, using a combined \$20.8 million or 23.7% of the total maximum. Approving HP's current application would bring this amount to \$38.3 million or about 45% of

the total maximum – keeping compliance with the 25% of the aggregate principal amount of guaranteed financing.

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. However, on a per school basis within HP's organization, the proposed financing is more in line with S&P's expectations.

Additional Considerations

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