STATE OF ARIZONA
OFFICE OF THE GOVERNOR

DOUGLAS A. DUCEY
GOVERNOR

EXECUTIVE OFFICE

DATE: April 20, 2017

TO: Credit Enhancement Eligibility Board

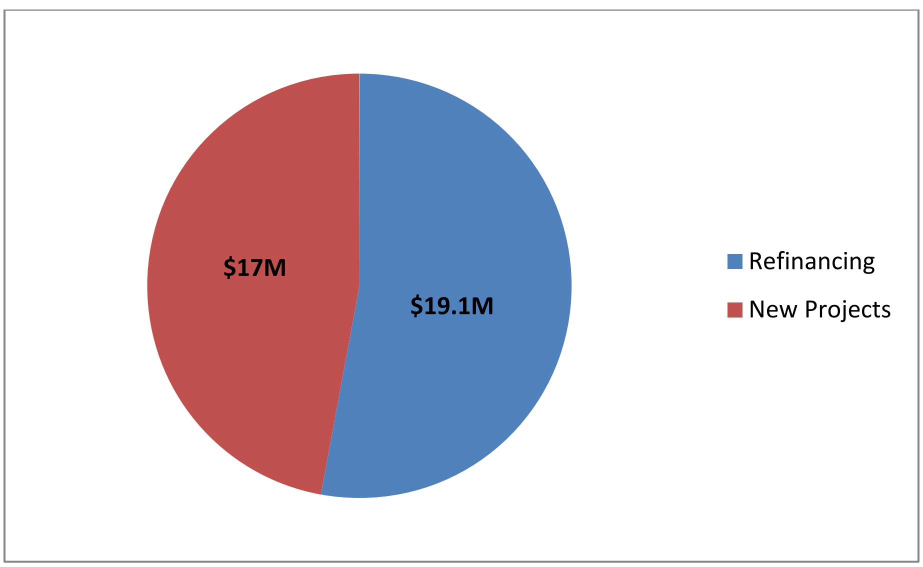
THRU: Dawn Wallace, Director, Governor's Office of Education

FROM: Charlie Martin, Senior Analyst, Governor's Office of Strategic Planning and Budgeting

SUBJECT: Arizona Agribusiness and Equine Center – Application for the Public School Credit Enhancement Program

Summary of Request

The Arizona Agribusiness and Equine Center (AAEC) has jointly applied as an Achievement District School and for participation in the Public School Credit Enhancement Program with a $36.1 million proposed financing. In summary, AAEC requests $19.1 million for refunding of existing debt and $17 million for new facilities construction and/or expansion (see Impact of Proposed Funding).



Based on staff review, AAEC meets the requirements to qualify as an Achievement District School and for conditional approval for the Public School Credit Enhancement Program. However, the proposed financing is significantly larger than was anticipated for an individual financing and guaranteeing the total amount could negatively impact the enhanced credit rating assigned to all program participants.

Recommendation

The Board has the following two options regarding AAEC'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, AAEC 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 $36.1 million
2. Approval of credit enhancement for an amount that is less than the full amount of the proposed financing (**Staff recommendation**)
    a. The amount that is proposed to be used for new projects is about $17 million
    b. The average size of an enhanced financing was assumed to be $10 million in initial credit rating agency review of the program
3. Denial of credit enhancement for any portion of the proposed financing

Note: Final Board approval of credit enhancement is subject to the AAEC'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

<u>Applicant Overview</u>

AAEC operates five charter schools: Phoenix (South Mountain Campus), Paradise Valley, Mesa (Red Mountain Campus), Avondale (Estrella Mountain Campus), and Prescott Valley. The locations currently enroll a total of 1,662 students. AAEC has indicated that the curriculum is "college preparatory with an agribusiness and science emphasis" and that students are able to attend classes at adjacent community colleges at no cost to the student. AAEC provided 2015 and 2016 AzMERIT test scores to demonstrate high academic outcomes.

Application Details:

Date Received: 3/15/2017
Date Complete: 4/13/2017
Deadline to Approve/Deny: 6/12/2017

Applicant Contact: Suzanne Drakes, Assistant Executive Director

Borrower's Counsel: Quarles & Brady
Bond Counsel: Kutak Rock
Underwriter Contact: Will McIntyre, Robert W. Baird & Co.
Bond Issuer: Yavapai County Industrial Development Authority

Achievement District Qualification

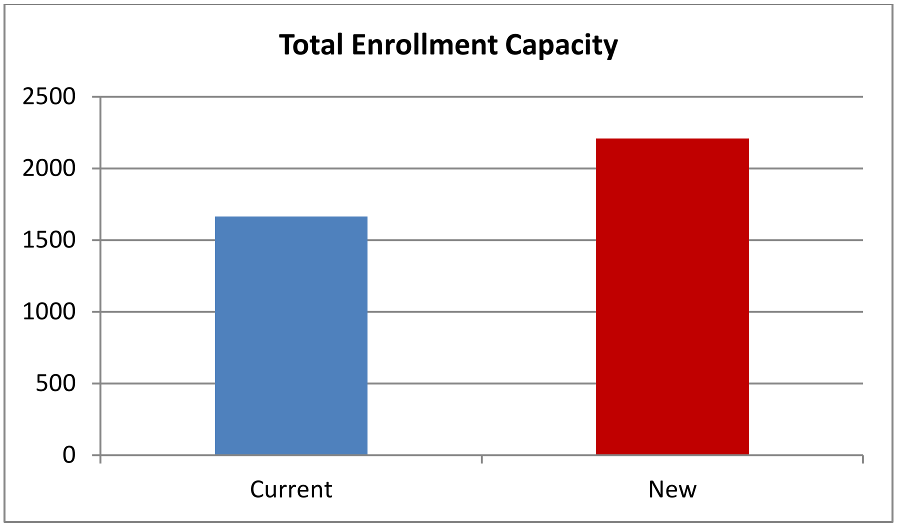
ARS § 15-2141 establishes criteria that an applicant must meet to qualify as an Achievement District School. Based on the review of documents provided by AAEC in their application, AAEC has met the criteria established in statute.

Requirement	**AAEC**
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

AAEC reports that it had a wait list of 377 potential students across the five campuses in FY 2017 based on the number of applications in excess of program capacity. Further, AAEC has partnered with Concordia Charter School Inc., an underperforming charter school in Mesa, to provide help with business services, curriculum development, and teacher training. AAEC reported that the percentage of students that qualify for free or reduced-price lunch ranges from 9.3% at the Paradise Valley campus to 67.6% at the South Mountain campus.

Impact of the Proposed Financing

AAEC projects that the proposed financing will expand capacity by 560 students. The proceeds will be used to refinance $19.1 million of existing debt, establish a new campus in Mesa and expand the Estrella Mountain campus located in Avondale. About $7.5 million will be used to build a new campus in Mesa, including purchasing and renovating an existing building to accommodate 17 classrooms, 2 labs, and related facilities. The new Mesa campus will serve about 260 students. About $9.4 million will be used to expand the Estrella Mountain campus to accommodate an additional 300 students. AAEC has estimated that savings from the refinancing will total about $150,000 per year and will be used to add instructional staff and help support increased debt service during the period of enrollment growth at the new facilities.



Eligibility for Credit Enhancement

ARS § 15-2155 requires that applicants provide proof of qualification 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.

AAEC'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. AAEC has an existing underlying credit rating of BB+ from Standard and Poor's and was last rated in August 2016. This is the 11th highest credit rating and is one rating below what is considered an investment grade rating (BBB- or higher). Most charter schools that have standalone credit ratings are rated BB, BB+, BBB-, or BBB. The August 2016 rating report stated that the rating agency would consider "a lower rating if the school issues additional debt and the MADS (maximum annual debt service) burden increases from current levels," so the credit rating on the proposed financing could be lower than the existing credit rating.

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 10% 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 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, AAEC 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 current and future 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. AAEC's proposed financing is significantly larger than the average financing assumed in the rating analysis.

<u>Additional Considerations</u>

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