



STATE OF ARIZONA
OFFICE OF THE GOVERNOR

DOUGLAS A. DUCEY
GOVERNOR

EXECUTIVE OFFICE

DATE: August 3, 2017

TO: Credit Enhancement Eligibility Board

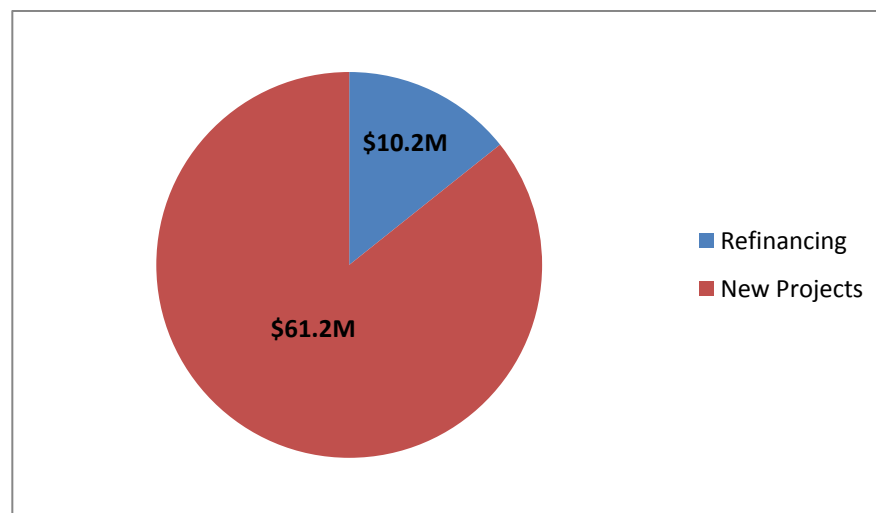
THRU: Dawn Wallace, Senior Advisor for Education, Governor's Office

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

SUBJECT: BASIS Schools, Inc. – Application for the Public School Credit Enhancement Program

Summary of Request

BASIS Schools, Inc. (BASIS) has applied as an Achievement District School and for participation in the Public School Credit Enhancement Program with a \$71.4 million proposed financing. In summary, BASIS requests enhancement for \$61.2 million in new debt that will be used to build, expand, or improve schools and \$10.2 million to refinance existing debt. The proposed financing will enable BASIS to increase capacity to serve an additional 3,003 students (see Impact of Proposed Financing).



Based on staff review, BASIS meets the requirements to qualify as an Achievement District School and for conditional approval for the Public School Credit Enhancement Program.

Recommendation

The Board has the following two options regarding BASIS' 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, BASIS 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 \$71.4 million
2. Approval of credit enhancement for an amount that is less than the full amount of the proposed financing
 - a. The largest financing that has previously been approved for enhancement was \$36 million to expand capacity to serve 1,000 wait list seats.
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

In 2016-2017, BASIS operated 17 schools that served over 12,000 students throughout the state. BASIS has indicated that its curriculum for grades 8 through 12 is widely recognized as one of the most academically-advanced high school programs in the world and that curricula for lower grades are designed to prepare students for a demanding high school program. BASIS has provided AzMerit and college entrance exam scores as well as information about the schools' national recognition to demonstrate high academic outcomes.

Application Details:

Date Received: 6/22/2017

Date Complete: 6/27/2017

Deadline to Approve/Deny: 8/26/2017

Applicant Contact: DeAnna Rowe, Executive Director

Borrower's Counsel: Warren Charter Law

Bond Counsel: Greenberg Traurig LLP

Underwriter: RBC Capital Markets

Bond Issuer: Arizona Industrial Development Authority

Achievement District Qualification

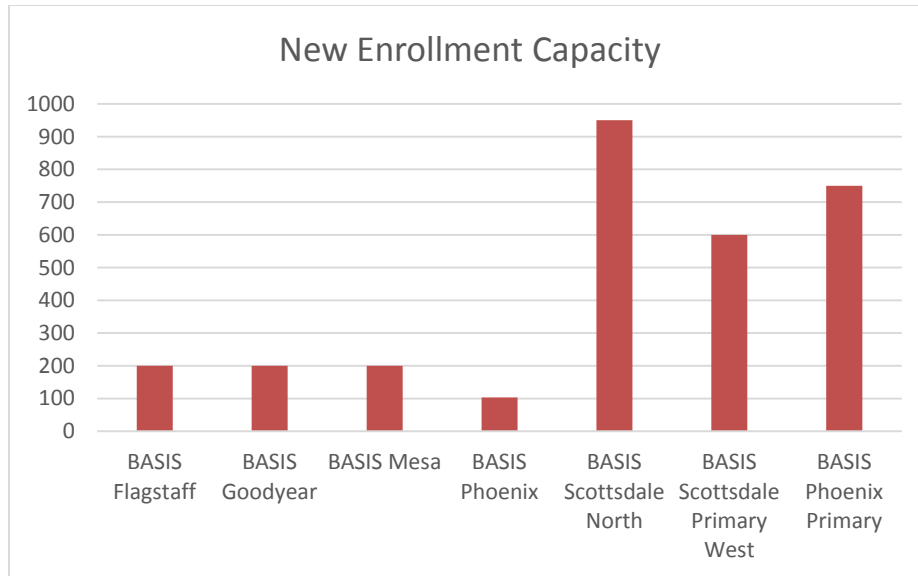
ARS §15-2141 establishes criteria that an applicant must meet to qualify as an Achievement District School. Based on the review of documents provided by BASIS in their application, BASIS has met the criteria established in statute.

Requirement	Status
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

As of May 19, 2017, BASIS reports a wait list of 7,135 potential students across all locations for the 2017-2018 school year. Additionally, BASIS has partnered with The STAR School, an underperforming charter school in Flagstaff, to provide assistance with training through the Arizona State Board for Charter Schools. BASIS reported that its schools have not historically collected information to determine free or reduced price lunch eligibility, but that BASIS Phoenix Primary South will be the first BASIS school to participate in the National School Lunch Program and BASIS expects 45% of families at the school to be eligible for free or reduced price lunch based on enrollment packets received to date.

Impact of the Proposed Financing

BASIS projects that the proposed financing will expand student capacity by about 3,003 students, including 2,300 from the construction of new schools that will open in Fall 2018, and 703 from the expansion of existing schools. The financing includes \$61.2 million new debt for new construction, expansion, and improvements and \$10.2 million to refinance existing debt. Construction and expansion projects include \$18.1 million for the construction of BASIS Scottsdale North, which will be designed to serve 600 students in grades 4 through 8 when it opens and is projected to grow to serve 950 students in grades 5 through 12, \$10.5 million for construction of the 600 student BASIS Scottsdale Primary West, and \$11.6 million for construction and renovations that will enable BASIS to open the 750 student BASIS Phoenix Primary and expand BASIS Phoenix by 103 students. Additionally, \$17 million will be used to expand the capacity of BASIS Flagstaff, BASIS Goodyear, and BASIS Mesa by 200 students each. In addition to the new debt, \$10.2 million will be used to refinance outstanding bonds for BASIS Ahwatukee. BASIS has indicated that the \$90,000 anticipated annual savings from the refinancing will be used to support classroom operations of all BASIS Arizona schools and allow for future expansion to add grades K-3 to BASIS Ahwatukee.



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.

BASIS' 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 December 2016, BASIS 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, BASIS has a large scope of operations and significant enrollment demand that are in line with higher-rated charter schools, but BASIS has relatively higher debt levels, lower cash reserves, and narrower operating margins compared to higher-rated charter schools.

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 20% 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 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 have not yet 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., the state's financial advisor, RBC Capital Markets, has advised that enhancing the full amount would not have a negative impact on the enhanced credit rating assigned to program participants. However, RBC also advises 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.

Additional Considerations

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