



STATE OF ARIZONA  
OFFICE OF THE GOVERNOR

DOUGLAS A. DUCEY  
GOVERNOR

EXECUTIVE OFFICE

DATE: November 2, 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 the Request**

BASIS Schools, Inc. has submitted a new application for credit enhancement that eliminates two previously-approved projects and increases the requested amount for six previously-approved projects by \$11 million. BASIS Schools, Inc. was approved as an Achievement District School and for participation in the Public School Credit Enhancement Program for a \$53.3 million proposed financing on August 3, 2017. The previous approval covered construction or improvements for eight schools to increase enrollment capacity by 3,003 student. The new request covers six schools to increase enrollment capacity by 1,680 students (see Impact of Proposed Financing).

The table below compares the August 3, 2017 approval to the current October 20, 2017 request:

<b>Description</b>	<b>Amount Approved 8/6/2017</b>	<b>Change to Request</b>	<b>Amount Requested 10/20/2017</b>
Phoenix Primary South	770,505	484,495	1,255,000
Goodyear	4,433,099	331,901	4,765,000
Phoenix	8,563,227	3,391,773	11,955,000
Scottsdale North	16,571,499	(16,571,499)	0
Scottsdale Primary West	9,581,705	(9,581,705)	0
Flagstaff	7,432,813	4,497,187	11,930,000
Mesa	3,918,300	991,700	4,910,000
Phoenix Primary	2,073,535	1,296,465	3,370,000
<b>Total</b>	<b>53,344,683</b>	<b>(15,159,683)</b>	<b>38,185,000</b>

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

### **Recommendation**

The Board has the following options regarding BASIS's application to the Public School Credit Enhancement Program:

1. Approval of credit enhancement for the full amount of the proposed financing of \$38.2 million
2. Approval of credit enhancement for an amount that is less than the full amount of the proposed financing
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 previously 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 lower grades are designed to prepare students for the 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: 10/20/2017

Date Complete: 10/31/2017

Deadline to Approve/Deny: 12/30/2017

Applicant Contact: DeAnna Rowe, Executive Director

Borrower's Counsel: Warren Charter Law

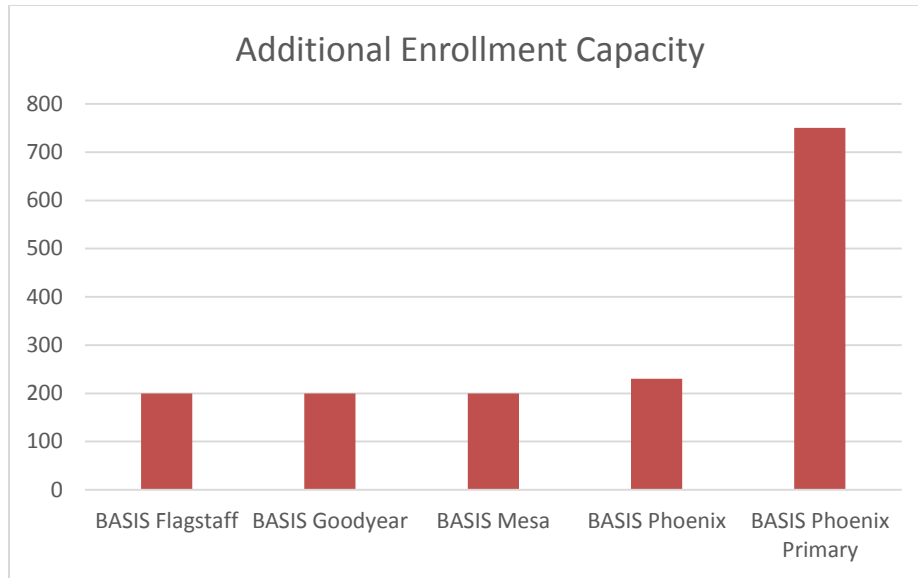
Bond Counsel: Greenberg Traurig LLP

Underwriter: RBC Capital Markets

Bond Issuer: Arizona Industrial Development Authority

#### Impact of the Proposed Financing

BASIS anticipates that the proposed financing will expand student capacity by 1,680 students. The proposed \$38.2 million in new debt will be used for new construction, expansion, and improvements. The projects include \$15.3 million for construction and renovations that will enable BASIS to open the 750-student BASIS Phoenix Primary and expand BASIS Phoenix by 230 students. Additionally, \$21.6 million will be used to expand the capacity of BASIS Flagstaff, BASIS Goodyear, and BASIS Mesa by 200 students each. Finally, \$1.3 million will be used to expand BASIS Phoenix South Primary by 100 seats.



### 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’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. In September, 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. The September rating report from S&P characterized BASIS’s financial profile as “vulnerable, with weak liquidity, very weak maximum annual debt service (MADS) coverage, and a high pro forma debt burden.” Additionally, the report stated that “In our view, BSI is at its debt capacity, barring financial improvement to levels needed to absorb additional debt.”

### 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 11% of the program's total capacity will be used to enhance this financing and approximately 12% of the program's total capacity will be used to enhance BASIS's financings.

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, RBC Capital Markets had previously advised as the financial advisor to the Board in the initial rating analysis, that enhancing the full amount would not have a negative impact on the enhanced credit rating assigned to program participants based on size of the borrowing alone. However, RBC also advised 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. RBC has not been requested to review and has not reviewed the applicant and no opinion of RBC is expressed regarding the credit or financial quality of the applicant or its application or any impact on the credit rating of the Program.

#### Additional Considerations

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