



STATE OF ARIZONA
OFFICE OF THE GOVERNOR

DOUGLAS A. DUCEY
GOVERNOR

EXECUTIVE OFFICE

DATE: October 18, 2017

TO: Arizona Public School Credit Enhancement Eligibility Board

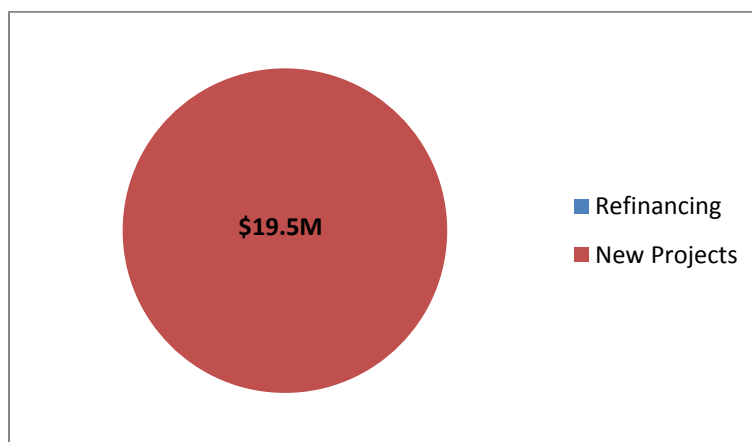
THRU: Dawn Wallace, Senior Advisor for Education, Governor's Office

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

SUBJECT: GreatHearts – Application for the Public School Credit Enhancement Program

Summary of the Request

GreatHearts has applied for participation in the Public School Credit Enhancement Program with a \$19.5 million proposed financing. In summary, the \$19.5 million will be used to acquire, renovate, and equip new school facilities (see Impact of Proposed Financing) to increase enrollment capacity by about 458 students. GreatHearts was approved as an Achievement District school in June 2017 and currently has \$34.2 million of outstanding bonds that are guaranteed by the Arizona Public School Credit Enhancement Program.



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

Recommendation

The following three options are available for the Board to consider regarding GreatHearts application to the Public School Credit Enhancement Program:

1. Approval of credit enhancement for the full amount of the proposed financing of \$19.5 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

GreatHearts operates 22 charter schools throughout the Phoenix area that serve a total of 12,252 students. GreatHearts has indicated that the curriculum includes significant exposure to the arts, an intense focus on math and science, and an intentional school culture with an honor code, uniforms, and a full athletic program. GreatHearts has also indicated that the schools have received numerous awards and recognition detailed in the application materials.

Application Details:

Date Received: 9/13/2017

Date Complete: 9/15/2017

Deadline to Approve/Deny: 11/14/2017

Applicant Contact: Erik Twist, Chief Innovation Officer & Sr. Vice President of Advocacy

Borrower's Counsel: Warren Charter Law

Bond Counsel: Greenberg Traurig

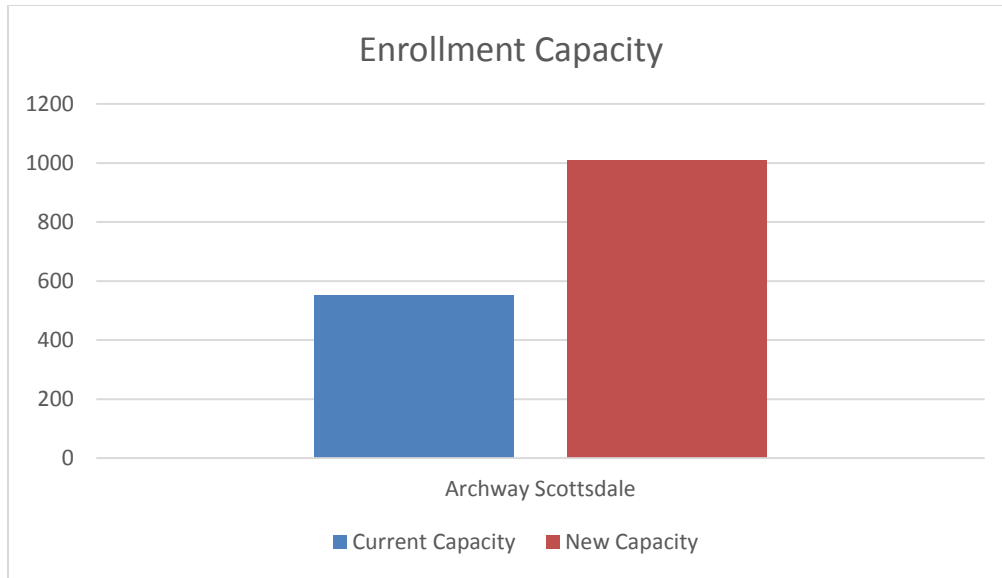
Underwriter: Robert W. Baird & Co

Financial Advisor: Buck Financial

Bond Issuer: Maricopa County IDA

Impact of the Proposed Financing

GreatHearts anticipates that the proposed financing will expand student capacity at Archway Scottsdale by about 458 students, increasing the total capacity at Archway Scottsdale for grades K-5 to 1,008 in 2018-2019 from 550 in 2017-2018. The \$19.5 million of new debt will be used to acquire, renovate, improve, and equip 9.56 acres of land that is adjacent to GreatHearts' Scottsdale Prep site. In addition to increasing enrollment capacity at Archway Scottsdale, the project will include athletic fields for Scottsdale Prep, which currently does not have a home field for football or soccer.



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.

GreatHearts’ 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. The proposed financing will be secured by the revenue of 19 of GreatHearts schools in Arizona, including Archway Scottsdale, and is expected to have an underlying credit rating of BBB-. This is the 11th highest credit rating and 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.

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% of the program’s total capacity will be used to enhance this financing and approximately 15% of the program’s total capacity will be used to enhance GreatHearts 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

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