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Douglas A. Ducey
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DATE: March 11, 2021

TO: Credit Enhancement Eligibility Board

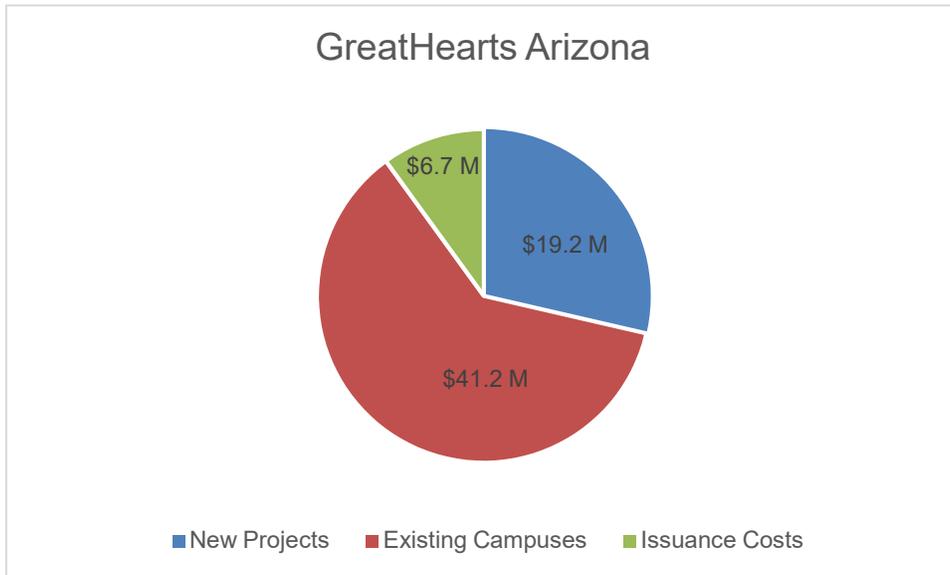
THRU: Matt Gress, Director, Governor’s Office of Strategic Planning and Budgeting

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

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

Summary of the Request

GreatHearts Arizona has applied for participation in the Public School Credit Enhancement Program for up to \$67.1 million in proposed financing. Of this amount, GreatHearts Arizona requests enhancement of about \$41.2 million to construct new campuses, about \$19.2 million to expand existing campuses and \$6.7 million for costs related to issuance. The proposed financing will enable GreatHearts Arizona to expand capacity by 1,575 seats.



Based on Staff review, GreatHearts Arizona 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 GreatHearts Arizona’s application to the Public School Credit Enhancement Program:

- A. Approval of credit enhancement for the full amount of the proposed financing of \$67.1 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

GreatHearts Arizona operates 21 charter schools throughout the Phoenix metro area that serves a total of 13,971 students, with a waitlist of 8,347 students for all schools in Arizona. GreatHearts also operates 10 campuses in Texas. GreatHearts Arizona plans to open two new school campuses in Buckeye and Phoenix, respectively, and expand four campuses in the West Valley that will serve over 1,400 additional students combined at full capacity. The Charter Board has approved of the new campuses and campus expansions.

School	Enrollment 2020-2021	Waitlist 2020-2021	FRL %
Anthem Prep (K-12)	780	400	13%
Archway Classical - Arete	522	390	24%
Archway Classical - Chandler	525	659	12%
Archway Classical - Cicero	522	320	14%
Archway Classical - Glendale	545	1,265	10%
Archway Classical - Lincoln	700	297	13%
Archway Classical - North Phoenix	810	570	17%
Archway Classical - Scottsdale (K-4)	1038	694	8%
Archway Classical - Trivium East/Buckeye	519	208	28%
Archway Classical - Trivium West	519	793	18%
Archway Classical - Veritas	707	675	13%
Arete (Mesa) Prep	556	45	23%
Chandler Prep	730	267	13%
Cicero Prep	487	45	14%
Glendale Prep	576	494	8%
Lincoln Prep	577	40	13%
Maryvale Prep (K-12)	807	306	77%
North Phoenix Prep	511	108	19%
Scottsdale Prep (5-12)	855	455	5%
Trivium Prep	882	606	20%
Veritas Prep	803	110	16%

GreatHearts Arizona was approved of the Credit Enhancement Eligibility Board as an Achievement School District at the Board’s June 1st, 2017 and October 18th, 2017 meetings and has provided verification that Achievement District School requirements continue to be met with the exception of approval to provide assistance to an underperforming school.

Requirement	Status
Assigned a letter grade of A, or an equivalent successor classification	Verified for 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 8,347 students on waitlist across GreatHearts Arizona network
Sound financial plan that contemplates operational costs and future enrollment growth	Financial Documents
Commitment to provide technical assistance to an underperforming school	Awaiting approval from an underperforming school.

According to the application, GreatHearts Arizona’s approach to student achievement utilizes the Core Knowledge curriculum for grades kindergarten through 5 and a rigorous classical liberal arts curriculum for middle-school and high-school students. The applicant reported that students’ average passing scores on the 2019 AzM2 test were 65% for English Language Arts (ELA) and 63% for Math compared to the statewide averages of 46% for ELA and 46% for Math for all tested grades.

Application Details:

Date Received: 12/23/2020

Date Complete: 01/25/2021

Deadline to Approve/Deny: 3/12/2021

Applicant Contact: Ramsey Margison, Director of Financial Planning and Analysis, GreatHearts Arizona

Borrower’s Counsel: Warren Charter Law, PLC

Bond Counsel: Engelman Berger, P.C.

Underwriter: Robert W. Baird & Co.

Bond Issuer: IDA of the County of Maricopa

Impact of the Proposed Financing

GreatHearts Arizona requests enhancement totaling \$67.1 million in proposed financing for the following purposes:

- 1) \$21.4 million to construct a new Archway Trivium campus in Buckeye. The new campus will allow the applicant to serve 556 students in grade K-8. The campus will include 49 classrooms, spaces for exceptional student services, support, and administrative staff, a multi-purpose room, gym, library, outdoor playground, and parking.
- 2) \$19.8 million to construct a new Anthem Prep campus in the northeast corner of the I-17 Frontage Road and W. Arroyo Norte Drive in Phoenix on approximately 10.12 acres of land. The new campus will allow the applicant to serve 301 students in grade K-12. The campus

will include 56 classrooms, spaces for exceptional student services, support, and administrative staff, a multi-purpose room, gym, library, outdoor playground, athletic field, and parking.

- 3) \$10.6 million to expand the existing Glendale Prep and Archway Glendale Campuses located in Peoria. This expansion will allow the applicant to serve 169 additional students at Glendale Prep and 151 students at Archway Glendale. The expansion includes purchasing three lots of land directly adjacent to the current campus, adding 16 new classrooms, a multi-purpose room, and additional parking.
- 4) \$8.6 million to expand the existing Trivium Prep and Archway Trivium West campuses located in Goodyear/Avondale on existing land. This expansion will allow the applicant to serve 60 additional students at Trivium Prep and 338 students at Archway Trivium West. The expansions include adding 6 new classrooms and a multi-purpose room for Trivium prep and 17 new classrooms at Archway Trivium West.
- 5) \$6.7 million related to issuance costs.

The applicant estimates that savings from credit enhancement will total \$9.8 million over the lifetime of the bonds, or about \$338,579 annually, and plans to use those savings to fund teacher salaries and for other educational costs such as instructional supplies and special education services. The present value of the savings, \$5.8 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.

GreatHearts Arizona'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.

GreatHearts Arizona has outstanding Series 2014, 2016 A&B per the FY 20 audit, 2017A&B, 2017C&D, 2018 bonds, and an outstanding Maryvale Prep loan. GreatHearts Arizona carries an investment grade underlying rating of BBB-, as assessed by Standard & Poors (S&P), with respect to Series 2014, 2016, and the Maryvale Prep Loan. Series 2017A&B and 2017C&D also carry this rating, plus an additional rating of AA- based upon the rating of the Arizona Public School Credit Enhancement Program.

The January 2021 S&P ratings report highlights GreatHearts Arizona's consistent history of surplus operations, recently improved lease adjusted maximum annual debt service coverage, a good 139 days of cash on hand, good demand, and experienced management team. The report notes the maximum annual debt service burden of 11% of FY 2020 operating revenue which is likely to rise given expected debt plans. The report also considers the potential for transition risk with corresponding financing needs as the organization pursues its longer-term growth plan. Additionally, the report indicated that GreatHeart's stable rating outlook reflects the expectation that it will meet projected enrollment targets

and sustain financial metrics consistent with the rating level, incorporating the potential additional debt likely to be issued in the spring of 2021.

The applicant’s FY 2019 and FY 2020 audits demonstrate primarily gains on both a cash and accrual basis. Based on S&P’s rating medians for charter schools for fiscal years 2018-2020, GreatHearts Arizona’s enrollment is larger and has a waitlist as a percentage of enrollment that is larger than comparably rated schools. Historical day’s cash on hand is lower and debt per student is in line with BBB- rated schools. Additionally, GreatHeart’s annual debt service coverage ratio is 1.2.

(Please see Appendix A for the Board-contracted Financial Advisor’s analysis of GreatHearts Arizona 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, along with the submittal from Highland Prep, if approved would fully consume the remaining capacity of this program.

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, along with the full amount proposed by Highland Prep, the program will not remain in compliance with the maximum program leverage ratio.

Currently, there are two applications (GreatHearts and Highland Prep) proposing to use the \$69.9 million of remaining program capacity. However, the applications as submitted--GreatHearts’ proposed enhancement of \$67.1 million and Highland Prep’s of \$17.5 million—exceed the program capacity by \$14.7 million.

Presently, GreatHearts utilizes \$53.7 million, or 15.3%, of the enhancement program. Highland Prep utilizes \$10.3 million, or 2.9%. If the Board approved the full amount requested by GreatHearts, the applicant’s share of program capacity would increase to \$120.9 million or 34.5%. In an alternative scenario in which the Highland Prep application is approved as submitted and GreatHearts receives the remaining capacity, GreatHearts would utilize \$106.2 million or 30.3% of total program capacity and fulfill 78.1% of their original enhancement request.

GreatHearts Funded as Proposed with Remaining Capacity to Highland Prep					
	Total Request	Amount of Request Funded	Percent of Total Request	Applicant Total Enhancement	% of Total Applicant Enhancement
GreatHearts	\$67.1 M	\$67.1 M	100%	\$120.9 M	34.5%
Highland Prep	\$17.5 M	\$2.8 M	16%	\$13.1 M	3.7%

Highland Prep Funded as Proposed with Remaining Capacity to GreatHearts					
	Total Request	Amount of Request Funded	Percent of Total Request	Applicant Total Enhancement	% of Total Applicant Enhancement
GreatHearts	\$67.1 M	\$52.4 M	78.1%	\$106.2 M	30.3%
Highland Prep	\$17.5 M	\$17.5 M	100%	\$27.8 M	7.9%

Most charter schools with underlying credit ratings are rated BB, BB+, BBB-, or BBB. However, if S&P fails to reassess the applicant’s underlying credit rating as 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. GreatHearts Arizona would not count against the 25% trigger since its latest underlying rating is BBB-, which is higher than the BB- requirement. However, staff does not expect for GreatHearts to count against the 25% as its latest underlying rating is BBB-.

The higher the enhanced credit rating assigned to guaranteed financings, the greater the benefit of the program to participants. The assumptions made by S&P 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. GreatHearts Arizona's proposed financing is larger than the average size of an enhanced financing assumed in S&P's initial analysis. However, on a per school basis within the GreatHearts organization, the amount is an average of \$10.6 million per school, which is more in line with S&P's expectations.

The program's credit rating may be adversely affected if any single applicant's share of the enhancement capacity exceeds 35% or if the remaining enhancement capacity of \$69.9 million is not fully utilized within the year.

Additional Considerations

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