MEMORANDUM

DATE: September 2, 2016

TO: David Damschen, State Treasurer

FROM: Bruce D. Williams
Zions Bank Public Finance

RE: Hawthorn Academy Application to the Utah Charter School Finance Authority

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The purpose of this report is to document Hawthorn Academy's ("Hawthorn," or the "School") adherence to the eligibility standards created for participation in the Utah Charter School Credit Enhancement Program (the "Program"). The analysis contained herein is based on Hawthorn Academy's full application to the State Charter School Finance Authority (the "Authority"), subsequent conversations with the School's Financial Advisor, validation of information contained in the application with data from the Utah State Office of Education, as well as additional information and documents submitted in response to follow up requests by the Authority.

The School has provided all information requested subsequent to the submission of the initial application. This report will examine each category of the Program's "Standards for Participation," including Basic Eligibility, Enrollment/Student Demand, Academic Performance, Management, Financial Performance, and Bond Documents. In each of these categories, the School met the basic eligibility requirements for participation in the Program, as detailed below.

This report should be examined in direct conjunction with the Letter of Certification for Hawthorn Academy from the State Charter School Board ("SCSB Letter"), which provides detailed analysis and historical information on Enrollment/Student Demand, and Academic Performance. The Academy has one unsuccessful mark on the Letter of Certification from the State Charter School Board. The category on which the State Charter School Board scored the school as "unsatisfactory" was concerning the standard by the SCSB which requires the statutory budget to be within 5% of the actual budgeted revenues and expenditures.

As reported in the SCSB Letter, during FY 14 Revenues were under projected by 10.15% and expenditures were over projected by 4.94%. The result of this projection error is a larger increase in fund balance than originally budgeted. In FY 15, Expenses were over projected by 13.22%.

In a letter from Hawthorn Academy, the school explained that in FY 14 it had inaccurately included in revenues, the amount of $700,000 for a land purchase which was actually coming out of fund balance. In the 2015 fiscal year, as Hawthorn Academy opened an additional campus, they budgeted for expenditures for the opening of the school which did not actually occur until FY 16, which resulted in the over projection. In each case, the fact that the school missed the standard was due to conservative budgeting.

Hawthorn Academy—Introduction

Hawthorn Academy is a charter school located in South Jordan and West Jordan, Utah. The two campuses serve students in grades K-9. The West Jordan campus began operations in 2009-2010 and the campus in South Jordan began operations in the 2015-2016 school year. Combined enrollment for the two campuses during FY 2016 was 1,469 students. Hawthorn Academy's enrollment cap is currently 1,550 students. The school's governing board has expressed that there is no intent to increase enrollment beyond the current enrollment cap. With strong retention and an adequate waiting list, the School should not have a problem retaining enrollment at or near its enrollment cap and maintaining this enrollment into the future.

Hawthorn Academy focuses on the teaching methodology of the International Baccalaureate program and strives for high academic achievement. Hawthorn Academy has the following mission statement and vision for students who attend the school and their families.

Mission Statement
Our mission is to provide an exciting and enabling learning environment where students will develop a desire to explore and understand the world around them; be inspired to set and reach personal goals, and become lifelong seekers of knowledge. We will provide challenging academics utilizing a proven methodology that will foster students who are responsible citizens, intellectually capable, and competitive in every aspect of society. Students will develop self-respect and self-discipline in a safe and supportive environment.

Vision Statement
Hawthorn Academy provides a safe environment where inquiry based, and data driven differentiated instruction fosters confident, independent learners who will become balanced, productive, contributing members of a global society.

The Project
The School plans to issue approximately $12,115,000 in revenue bonds, which will be used to purchase the school's existing South Jordan facility which consists of a 55,487 square foot building and 7 acres of land.

Basic Eligibility

1. The 2016 Hawthorn Academy bonds will be issued through the Authority.

2. The SCSB Letter indicates that KGM is in good standing with the State Charter School Board, with one exception concerning meeting the budgeting standard. This exception is the result of conservative budgeting by the school.

3. The School received an investment grade rating of "BBB-" from Standard & Poor's ("S&P") on the 2016 bonds.

   The S&P rating report states the following:

   - Strong unrestricted reserves of 252 days' cash on hand based on fiscal 2015 financials;
   - Strong operations, with a positive operating margin of over 13% for fiscal 2015, and expectations of fiscal 2016 to post positive operations;
   - Strong demand demonstrated by successful opening of the South Jordan campus and a waitlist of more than 81% of enrollment; and
   - The favorable charter school environment in Utah, which includes evergreen charters that are automatically renewed annually unless terminated by the charter authorizer or the school's governing board.

   Offsetting factors includes our assessment of HA's:

   - High pro forma debt burden of 39.3% on fiscal 2015 financials, though we note this should come down with fiscal 2016 financials;
   - Potential start-up risk related to the proposed project as HA only has one year of operations at the new campus; and
   - The possibility that the charter could be revoked due to noncompliance with the terms of the charter (as with all charter schools) prior to the bonds' final maturity.

4. Hawthorn Academy recently completed its 7th full year of operations. Financial operating history, as demonstrated by past audited financials, cash position, and increasing unrestricted fund balance, is satisfactory.

5. The School has a defined and specific mission as noted in their mission and vison statements listed above.

6. Hawthorn Academy issued bonds in 2014. The 2016 bonds will be on parity with the 2014 bonds and will be used to purchase the South Jordan campus which is currently being leased by the Academy. The school is current on all outstanding debt obligations.

Enrollment/Student Demand

7. Hawthorn Academy's two school campuses had a total of 1,469 students enrolled during the 2015-2016 school year. The South Jordan campus opened during the 2015-16 school year with an enrollment of 651 students. When the additional school was approved by the State Board of Education the enrollment cap increased by 740 students to a total enrollment cap of 1,550 students.

8. Enrollment at Hawthorn Academy has increased each year since operations began in 2009. Current enrollment is at 95% of the school's enrollment cap with the school anticipating adding students up to its enrollment cap of 1,550 students during the 2016-17 school year. Table 1 from the SCSB Letter includes detailed enrollment history back to the 2009-2010 school year.

9. Hawthorn Academy exceeds the enrollment standard established by the SCSB, with the most recent total re-enrollment rate of 88.2%. Over the past six years, the School has ranged between 78.9% and 88.2% in reenrollment rates. Table 2 from the SCSB Letter details historical enrollment and re-enrollment.

10. The School exceeds the ADM rate requirement. Over the last five years, Hawthorn's Average Daily Membership rate has been as follows:

School Year	ADM Rate
2011-2012	99.2%
2012-2013	99.1%
2013-2014	99.0%
2014-2015	97.8%
2015-2016	98.4%

11. The School has provided wait list statistics by grade, and has provided the detailed waiting list that includes descriptive and personal information on potential students to the Deputy State Treasurer. The waiting list from the application includes 1,983 potential students applying for admission in the 2016-2017 academic year.

The waiting list is very strong in grades 1-5 and includes a satisfactory amount of students for grades 6-9. Given the retention rate for the school and waiting list in the lower grades, if the students currently enrolled in the two campuses in grades 1-5 continue their enrollment as they are promoted to the next grade each year, the school should have no problems meeting its enrollment projections.

Academic Performance

12. The SCSB Letter indicates that the School meets required academic standards. Table 3 from the SCSB Letter provides a breakdown of Hawthorn Academy 's performance. The "B" grade for both the 2014 and 2015 school years shows that the academic performance of Hawthorn Academy is above average.

Management

13. The School has adopted reasonable management policies and practices that guide financial, debt, and risk management. The Board has adopted an acceptable Succession Plan as well as a Financial and Risk Management Plan. No formal policy was provided in the application concerning post issuance compliance.

    In reviewing the school's past compliance with posting continuing disclosure items on EMMA, we found that Hawthorn Academy has filed all required items as detailed in the Continuing Disclosure Agreement associated with the Series 2014 Bonds. On several occasions, Hawthorn Academy was late when filing the quarterly statements. Additionally, Hawthorn Academy was late filing its Additional Bond Information. Hawthorn Academy should have filed a "failure to file on time notification" for each of the late disclosure filings. When requested to provide information concerning the past late filings, the School provided the following explanation.

    "[They are] aware of the late filings that came up especially early, especially when [they] were dealing with the GAAP treatment of the debt extinguishment. [Academica West has] retooled responsibilities here at Academica West and have employees dedicated completely to debt service reporting and compliance, who are in constant communication with the trustee.

    Hawthorn has striven to meet all of its requirements and is learning how to be better at this task. As such, Hawthorn and its consultants are positioning themselves to better continue to meets its CDU and ensure fuller compliance. "

14. Hawthorn Academy has a six-member board. The board members have a diverse set of backgrounds, which include business, engineering, finance, law and engineering. The Board serves staggered terms.

15. The School uses Academica West , LLC to provide management, accounting and reporting services.

16. As noted under Table 4 in the SCSB letter, Hawthorn's historical budgeted revenues and expenditures have in several cases not met the State Charter School Board

recommended standard of the statutory budget to be within 5% of actual revenues and expenditures. The SCSB letter includes a breakdown of adherence to budgeted revenues and expenses over the past three years. The variances which exceeded the 5% standard in the 2014 and 2015 fiscal years are due to conservative budgeting on the part of the school as noted previously in this report.

Financial Performance

The School meets the requirements for the Financial Performance section of the application.

17. Projections used by the School in financial forecasting appear reasonable. Hawthorn Academy seems positioned to continue and improve its healthy financial standing of the past.

The school has forecasted realistic revenue growth through 2020. For Fiscal Year 2017 revenues are estimated to grow at 12% due to addition of students up to the enrollment cap and additional revenues due to SB 38 from the 2016 session of the Utah Legislature. Through fiscal year 2020, revenues are estimated to grow by 3% per year. Expenditures are forecasted to grow at a similar rate to expenses. The School appears to be in a healthy financial position.

18. Debt Coverage Ratio

Requirement	Measure	Sufficient?
At least 105%	173%	Yes

Debt coverage ratio is calculated by dividing total revenues available for debt service by the maximum annual debt service payment anticipated for the bonds. Revenues available for debt service is calculated by taking 2015 net income from operations of $734,664 and adding back depreciation expense of $342,355 and interest expense of $735,379. This leaves net revenues available for debt service of $1,812,398. When this number is divided by maximum annual debt service of the existing bonds of $1,046,781, the coverage is 173%.

	2013	2014	2015
Net Income Available for Debt Service	$1,906,558	$1,859,910	$1,812,398
Maximum Annual Debt Service	1,046,781	1,046,781	1,046,781
Debt Coverage Ratio	182%	178%	173%

Based on projected revenues, expenditures and new debt service after the refunding, debt service coverage is projected to be between 151% and 219% through fiscal year 2018.

	2016	2017	2018
Net Income Available for Debt Service	$1,581,897	$2,516,066	$3,805,672
Maximum Annual Debt Service (New)	1,735,031	1,735,031	1,735,031
Projected Debt Coverage Ratio	151%	145%	219%

19. Debt Burden Ratio

Requirement	Measure	Sufficient?
Less than 25%	19.9%	Yes

The debt burden ratio requirement is based on the level of the School's fund balance, which we calculate at 69% (cash of $2,875,510 divided by total operating expenses net of depreciation of $4,180,716). The debt burden ratio is calculated as maximum annual debt service ($1,046,781) divided by unrestricted operating revenues ($5,257,735), taken from 2015 financial statements.

	2015	2014	2013
Maximum Annual Debt Service	$1,046,781	1,046,781	1,046,781
Unrestricted Operating Revenues	5,257,735	5,036,001	4,975,808
Debt Burden Ratio	19.9%	20.8%	21.0%

20. Operating Margin

Requirement	Measure	Sufficient?
At least 7%	34.5%	Yes

Hawthorn Academy's operating margin requirement of 7% or greater is based on the calculation for days cash on hand (calculated as cash divided by operating expenses multiplied by 365) of 251 days. Operating margin of 34.5% is calculated by dividing net income available for debt service of $1,812,398 (see calculation under Debt Coverage Ratio) by total revenues of $5,257,735.

	2015	2014	2013
Net Income Available for Debt Service	$1,812,398	$1,859,910	$1,906,588
Revenues	5,257,735	5,086,001	4,975,808
Operating Margin	34.5%	36.9%	38.3%

The School has exceeded the operating margin requirement in each of the past three years.

21. Current Ratio

Requirement	Measure	Sufficient?
At least 150%	444%	Yes

The current ratio is defined as current unrestricted assets divided by current liabilities (including current year debt service).

	2015	2014	2013
Current Assets	$3,032,131	$2,288,942	$2,236,792
Current Liabilities	683,123	790,610	798,223
Current Ratio	444%	290%	280%

Bond Documents

20-23. HAWTHORN's legal bond documents have been reviewed by Ballard Spahr in their capacity as issuer's counsel to the Authority, and all requirements have been incorporated. In addition, Chapman & Cutler, as bond counsel to the Authority, has confirmed that each of the required legal provisions is present in the bond documents.