**MEMORANDUM**

**DATE:**  Tuesday, August 20, 2019

**TO:** David Damschen, State Treasurer and Utah Charter School Finance Authority Board

**FROM:** Johnathan Ward, Senior Vice President of Zions Public Finance

**RE:** Wallace Stegner Academy
Application to the Utah Charter School Finance Authority

**Executive Summary**

**\*\*\*Unique draw structure that differs from other structures seen to date. See “Plan of Finance” below for additional details.\*\*\***

|  |  |
| --- | --- |
| Borrower: | Wallace Stegner Academy |
| Management Company: | Academica West |
| Municipal Advisor: | Lewis Young Robertson & Burningham, Inc.; David Robertson |
| Borrower’s Counsel: | Farnsworth Johnson, PLLC: Brandon Johnson |
| Underwriter/Placement Agent: | DA Davidson; Matt DeAngelis |
| Bond Counsel:  | Gilmore & Bell, PC; Ryan Warburton |
| Issuer’s Counsel: | Dorsey Whitney; Rhonda Skoby |
| Trustee:  | Zions Corporate Trust; Shelene Brown |
| Par Amount: | $28,000,000 |
| Enhancement Requested: | No |
| Purpose: | Purchase the existing campus out from developer lease including a possible “addition” as described in the purchase agreement; secure funding to potentially acquire, construct, and furnish a second campus; fund a debt service reserve fund; and pay costs of issuance. |
| Structure: | Multi-draw structure with draws allowed for different projects and interest accruing on funds drawn. Draws are conditioned upon provisions outlined herein. Once drawn, bonds would be repaid with a level amortization of principal and interest over 30 years. Interest rates would be set for 10 years at the time of the draw and reset to an agreed upon index consisting of a specified basis point addition to 10-yr MMD. The Bonds can be optionally redeemed if better rates are available in the market. 5-year optional redemption provisions included.  |
| Term: | 30-year amortization with optional redemption starting at year 5. |
| Rating: | Not rated |
| Costs of Issuance Estimate:  | $297,000 |
| Underwriter Fee Estimate: | $9.00/$1,000 ($252,000 or $123,795 for the first draw) |
| Potential Conflicts: | Zions Corporate Trust and Zions Public Finance are affiliated entities. |
| Litigation: | None of which we are aware. |
| Recommendation: | Approve funds sufficient to allow Wallace Stegner Academy to purchase the existing campus from the developer. Approve with the knowledge that making future judgments from a short operating history has inherent risks. *Request that Wallace Stegner Academy file a new application when a charter amendment is in place allowing an additional campus and sufficient operating history for the new campus is available.*  |

The purpose of this report is to document the adherence of Wallace Stegner Academy (“WSA,” or the “School”) to the application requirements of the Utah Charter School Finance Authority conduit issuance program. The analysis contained herein is based on WSA’s application to the Utah Charter School Finance Authority (the “Authority”) and inquiry for clarification of the Municipal Advisor.

**Introduction**

The School is a non-profit, 501c3 designated, public K-8 charter school with one campus located in Salt Lake City, Utah. The School was approved by the Utah State Charter School Board (the “SCSB”) to begin enrolling students for the 2016-2017 school year.

The School lists the following mission and vision.

**MISSION**

Wallace Stegner Academy will foster a community of active learners through academic rigor and citizenship by providing an opportunity for at risk students to close the achievement gap and achieve academic excellence through

* Academic rigor
* Direct instruction
* Data-driven instruction
* Ability-based mathematics, language arts, and reading classes
* Positive learning environments
* Character development

**VISION**

The school will foster a community of academic rigor and citizenship as evident through its school-wide culture, after school activities, and civic-based community involvement. Our vision is to create a school that will in five years provide a critical and reliable alternative to mainstream education, especially for English Language Learners and students who struggle in a typical classroom. Furthermore, the majority of the school’s student population will read at grade level, deploy academic language proficiently, and demonstrate developmentally proficient skills in writing and mathematics.

**Charter Details.** The School, initially applied for its charter in December 2014 with a maximum enrollment cap of 690 in the first year increasing to 810 by the 3rd year. The charter is renewable on an annual basis.

**Enrollment/Student Demand**

Total enrollment for the 2018-2019 school year was 620 students which is below the enrollment cap of 810. This represents a 12.9% increase from 2017-2018 enrollment of 549 students. It was noted that the School represented a 200+ student waitlist for the 2017-2018 school year. These students were not enrolled according the School and it’s MA to match desired program implementation and work within their physical building capacities. The re-enrollment rates for the School are near 80% (and appear to be improving) and Average Daily Membership (ADM) was near 100% the last two years.





**Academic Performance**

The School performed below state average in each area measured by the 2018 SAGE testing. The School performed similarly to the overall performance of the Salt Lake City School District and outperformed the Granite School District on average.



**Management**

1. The School currently has a five-member board. The board members have a diverse set of backgrounds, which include agricultural science, healthcare services, education, aviation, and banking and economic development.
2. The School adopted the policies and proceduresto guide with policies on: capitalization and expensing; cash handling; procurement; and financial reporting. The School does not appear to have policies in place for: banking; debt, investments; reserves; or specific financial minimums, targets and ratios that we could find. The Board has an acceptable policy concerning continuing disclosure and post-issuance compliance approved June 20, 2019.
3. The School contracts with Academica West for bookkeeping, recordkeeping, financial reporting, payroll, budgeting, financial projections, human resources, recruiting, enrollment, and marketing.

**The Project**

The School plans to issue approximately $28,000,000 in revenue bonds, which will be used to:

1. Acquire the existing Salt Lake City campus out from the developer lease.
2. Secure funding authorization for a contemplated second campus, which at this point is not identified.
3. Fund a debt service reserve fund
4. Pay costs of Issuance

**Plan of Finance**

As provided in the application, the School intends to sell $28,000,000 of unrated bonds via a negotiated limited offering to clients of Hamlin Capital Management, LLC (“Hamlin”), with D.A. Davidson & Co. (“Davidson”) serving as underwriter. The School is not seeking credit enhancement through the Utah Charter School Credit Enhancement Program. The bonds would be tax-exempt fixed rate bonds for the purpose of acquiring the current building with improvements, securing funding for a potential expansion to a second campus, funding a debt service reserve fund, and paying costs of issuance. The bonds will feature a draw structure allowing the School to return to D.A. Davidson and Hamlin to finance the second campus without incurring the additional costs of a second application to the Authority. Final maturity is in 2049 for the first draw with a final maturity on the second draw dependent upon timing.

The School is negotiating terms through Davidson, as the underwriter, with Hamlin. Per the terms of purchase, there will be an initial draw to finance the purchase of the existing campus. A second draw can be made to finance an envisioned second campus. The second campus has not been authorized by nor applied for with the State Charter School Board. Hamlin has conditioned approval for the second draw on the following:

* Funds are drawn within three years
* Charter expansion approval by State Charter School Board
* Real estate due diligence must be completed to Hamlin’s satisfaction
* Guaranteed price contract containing liquidated damages equal to daily debt service on the bonds and payment and performance bonds satisfactory to Hamlin are in place
* Business plan must demonstrate ability to repay debt acceptable to Hamlin
* No event of default shall have occurred on the first draw
* At least $200,000 of equity to be funded at the time of the second draw
* Total debt per square foot can be no greater than $240

Interest rates will be determined on the following basis: 315 basis points over 10-yr AAA MMD with an interest rate floor of 5.25% for the first draw; and 350 basis points over 10-yr AAA MMD with an interest rate floor of 5.5% on the second draw. The interest rate of the first bonds will reset at the second draw. Currently the bonds would receive the interest rate floor. An increase in 10-yr AAA MMD over 86 basis points above 2.10% would result in a higher reset rate than the rate contemplated in the application. 10-yr AAA MMD has averaged 2.08% since 2012 and 4.55% since 1982. Tying the rate to MMD could lead to a conflict between the parameters approved by the Authority and the agreement between the School and Hamlin. The bonds will be callable at par beginning in year 5 after issuance of each draw. Any taxable portion will be callable anytime.

The School has also agreed to the following covenants, which would have to be in place when considering a second draw:

* Maintain 60 days cash on hand;
* Maintain 1.1x debt service coverage;
* Maintain a $200,000 repair and replacement fund;
* 1.2x historical and 1.3x pro-forma additional bonds test;
* Maintain charter in good standing;
* Insurance coverage at levels requested by Hamlin;
* Various financial and administrative reports are to be provided yearly and quarterly;
* School shall provide any monthly financial statements when requested by Hamlin; and
* Hamlin can require the School apply for a rating at their own expense.

The bonds are secured by an assignment and secured interest in the revenues of the School and trust accounts, and a security interest and pledge of the deed of trust in the land and building located at:

* 980 South Bending River Road, Salt Lake City, Utah 84104

**Financial Performance**

**Summary:**

Cash on hand is above Board standards each year for which we have data (2017 and 2018). The general fund balance is greater than 15% of the following year’s operating expenses as of the last audited fiscal year. The pro-forma debt-service coverage ratio is above 1.1x. The working capital reserve exceeds 3%. Projections for 2024 were requested on 7/15/19 but as of yet have not been provided. We have projections through 2023.

1. Financial forecasts used by the School and once growth is more stabilized show annual revenue growth of 4.83%, annual expenditure growth of 4.24%, and annual enrollment growth of 9.51% until the school reaches maximum capacity. UCSFA guidelines for projections suggest that actual revenues and expenditures should not vary more than five percent from budgets. The School was within those parameters in 2017 but variation in 2018 exceeded guidelines. The 2018 variation did not impair operations.



1. Cash Position

|  |  |  |
| --- | --- | --- |
|  | **Benchmark** | **Measure at end of FY 2019\*** (\*Unaudited) |
|  | At least 30 days | 86 |

The cash position of the School was calculated to be 86 days of cash on hand at the end of fiscal year ended June 30, 2019 per unaudited financials. This is above the 30 days of cash on hand identified by the application. The School had 38 days cash on hand in 2017.



1. Fund Balance

|  |  |  |
| --- | --- | --- |
|  | **Benchmark** | **Measure at end of FY 2019\*** |
|  | At least 15% of following year expenses | 16% |

At the end of FY 2018, the School’s general fund balance was $834,761 which is approximately 16% of the school year ending in 2020’s estimated operating expenses.

 

1. Debt Coverage Ratio

|  |  |  |
| --- | --- | --- |
|  | **Benchmark** | **Measure at end of FY 2019\*** |
|  | At least 110% | 235% |

Debt Coverage Ratio is calculated by dividing Net Income Available for Debt Service by the Annual Debt Service payment anticipated for the bonds. Net Income Available for Debt Service is calculated by taking 2019 net income from operations of $117,106 and adding back depreciation expense of $475,451, interest expense of $588,051, and the facility lease payments of $740,901. This leaves Net Income Available for Debt Service of $1,921,509. When this number is divided by Annual Debt Service on the existing loans and leases of $603,387 the coverage is 235%. Based on projected revenues and expenditures, the debt service coverage will be 151% (or 1.24x) in 2020, drop to 142% in 2022 before rising slightly to 152% by 2023.



1. Debt Burden Ratio

|  |  |  |
| --- | --- | --- |
|  | **Benchmark** | **Measure at end of FY 2019\*** |
|  | Less than 25% | 16% |

The Debt Burden Ratio benchmark is based on the level of the School’s Fund Balance Ratio. The Fund Balance Ratio of 19.3% as of FY 2019 puts the School in the Debt Burden benchmark range of less than 25% because maintaining a high fund balance should provide the school with room to meet a higher burden. The Debt Burden Ratio is calculated as Maximum Annual Debt Service divided by Unrestricted Operating Revenues (not including debt service related cash) as illustrated below. This ratio improved from 2017 to 2019 with a step up in 2020 and projected to improve from 2020 through 2023.



1. Operating Margin

|  |  |  |
| --- | --- | --- |
|  | **Benchmark** | **Measure at end of FY 2019\*** |
|  | At least 7% | 37.6% |

Operating margin of 37.6% is calculated by dividing Net Income Available for Debt Service of $1,921,509 (see calculation under Debt Coverage Ratio) by unrestricted Revenues of $5,106,089. The historical and future projected performance are shown below. The School has exceeded the operating margin benchmark in each of the past two years. The Operating Margin is projected to decline by 2023 but remain well above the benchmark.



1. Current Ratio

|  |  |  |
| --- | --- | --- |
|  | **Benchmark** | **Measure at end of FY 2019\*** |
|  | At least 150% | 358% |

The current ratio is defined as current unrestricted assets divided by current liabilities (including current year debt service). Fiscal year 2017-2019 financials show assets exceeding liabilities, including current year debt service, as illustrated below.



**Bond Documents**

Legal bond documents are being reviewed by Dorsey Whitney in their capacity as Issuer’s Special Counsel to the Authority, and all requirements are being incorporated. In addition, Gilmore & Bell, as Bond Counsel, will confirm that each of the required legal provisions will be present if not already in the bond documents.

**Continuing Disclosure**

The application requires the School to certify compliance with continuing disclosure requirements including; financial disclosure, arbitrage rebate calculations, and Form 990 filings. The School does not have any outstanding bonds requiring continuing disclosure. The School provided 2015, 2016, and 2017 990 filings but not 2018.

**Other Notes**

Issues in tracking average daily membership and waitlists were detected by our information requests. The School has described these as glitches in the internal tracking software.

2019 figures are based on unaudited financials.

Members of Academica West, the management company used by the school, own Rose Park School Development, LLC, the current owner/lessor of the Salt Lake City campus.