Arlington Higher Education HR BBB+ (G)

Education Revenue Bonds Series 2014
Trinity Basin Preparatory, Inc.

Corporates
December 31st, 2020

Rule 17g-7 Information Disclosure Form

Ratings

Series 2014 A	HR BBB+ (G)
Outlook	Stable

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Definition

The issuer or issue with this rating provides moderate safety for timely payment of debt obligations. Maintains moderate credit risk on a global scale, with weakness in the ability to pay in adverse economic scenarios.

The Rating Action Commentary (RAC) associated with this disclosure form is an integral part of the form.

1. **Symbol, Number, or Score in the Rating Scale used by HR Ratings as required by Paragraph (a)(1)(ii)(A) of Rule 17g-7:**

Entity/Instrument	Rating Action	Rating Type	Rating Code
Arlington Higher Education Finance Corporation Education Revenue Bonds, Trinity Basin Preparatory, Inc. Series 2014A	Review	Long Term Rating	HR BBB+ (G) / Stable

2. **Version of the Procedure or Methodology used to determine the credit rating as required by Paragraph (a)(1)(ii)(B) of Rule 17g-7:**

The rating assigned by HR Ratings to the entity is based in accordance with the following methodologies established by the rating agency:

- Charter Schools Credit Risk Evaluation, February 2015
  https://www.hrratings.com/docs/metodologia/New%20Charter%20Schools%20Methodology%20R.pdf

3. **Main assumptions and principles used in constructing the procedures and methodologies to determine the credit rating as required by Paragraph (a)(1)(ii)(C) of Rule 17g-7:**

Principles:

The bonds rated are considered as a general obligation of the entity. Therefore, the methodology mentioned before is based on the evaluation of the credit quality of the whole entity. The rating process consists of two basic components:

- Determination of the Initial Rating or Quantitative analysis:

  HR Ratings makes a quantitative analysis of audited financial statements that provides insight of the financial administration of the entity. Taking in consideration the historical analysis and guidance given by the entity of the projected financial statements, HR Ratings projects, for the next five years, the financial statements in a base and a stress scenario. In order to validate guidance given by the entity, it is compared with historical data and guidance given in past years.

  Another important concept in the Charter Schools methodology is the projection of enrollment which HR Ratings makes considering also guidance given based on historical information, expansion plans, demand and competition. Enrollment determines the federal and state recourse that the school receives.

  Once projections are made, our model calculates the Free Cash Flow (FCF), which is the core concept in order to calculate the four metrics that determine the initial rating. These four metrics are: i) Debt Service Coverage Ratio (“DSCR”), ii) DSCR with cash, iii) Years of Payment and iv) “MALC”. The model calculates a weighted average between these metrics and between years in both base and stress scenarios, then these two numbers are weighted to obtain one that is associated to a rating.

- Qualitative Adjustments to the initial rating:

  Based on a qualitative analysis that takes in consideration various factors that could have an impact on the entity´s credit risk, the initial rating may have a multi-notch adjustment. These factors are:

a) Management and future debt instrument issuance: HR Ratings takes in consideration the strength and diversity of the management team and the board of directors by analyzing each member's experience and field of expertise. On the other hand, the analysis takes into account a responsible policy of debt issuance.

b) Demographic trends and competition: The demand factor is key to determine enrollment that defines most of the income that the school receives. Demographic trends in the areas where the school is located are key to determining demand, as well as the competition that the school faces with their counterparts.

c) Academic performance and other services: One of the main qualitative risks is the revocation of the charter, this can be a result of poor academic performance. The student grades and other measurements of academic performance are obtained by public sources from a third party.

d) State regulation and legislation: Another risk of revocation of the charter comes from any change in the state regulation and legislation, this could also lead to an adjustment in the initial rating.

Assumptions:

- **State and Federal Revenue:** Our analysis assumes a certain level of stability in the state and federal revenue received by Charter Schools, in which they depend to operate.
- **State Legislation:** We assume that the legislation that allows Charter Schools to operate will not have any change that could generate trouble in the operation of the school or to the revocation of the charter.
- **Debt Issuance Policy:** HR Ratings assumes that the school management will follow the policy of debt issuance, in order of not having changes in the financial projected metrics.
- **Expansion Plans:** The school will be able to meet the expansion plans in order to reach the enrollment numbers incorporated in the financial model.
- **Academic Performance:** The school will be able to maintain the academic performance required by the regulation to keep the charter license.

4. <u>Potential limitations of the credit rating as required by Paragraph (a)(1)(ii)(D) of Rule 17g-7</u>

- HR Ratings does not validate, guarantee or certify the accuracy, correctness or completeness of any information and is not responsible for any errors or omissions or for results obtained from the use of such information.
- Ratings and/or opinions assigned by HR Ratings are based on an analysis of the creditworthiness of an entity, issue or issuer, and do not necessarily imply a statistical likelihood of default.
- The credit ratings do not opine on the liquidity of the issuer´s securities or stock.
- The credit ratings do not consider the possible loss severity on an obligation default.
- The credit ratings are not an opinion of the market value of any issuer´s securities or stock, or the possibility that this value suffer a deterioration.

5. <u>Information on the uncertainty of the credit rating as required by Paragraph (a)(1)(ii)(E) of Rule 17g-7</u>

The Analysis Committee noted no material limitations on the reliability, accuracy and quality on the data relied on in determining the credit rating.

The Analysis Committee noted no material limitations on the scope of historical data or on the accessibility to certain documents or other information that would have better informed any credit rating listed in this disclosure form.

6. <u>Use of third party due diligence services as required by Paragraph (a)(1)(ii)(F) of Rule 17g-7</u>

HR Ratings did not use third party due diligence services for its rating actions.

7. <u>Use of servicer or remittance reports to conduct surveillance of the credit rating as required by Paragraph (a)(1)(ii)(G) of Rule 17g-7</u>

HR Ratings does not use Servicer or Remittance Reports to conduct surveillance of the rating actions listed on Page 1.

8. Description of types of data about any obligor, issue, security or money market instrument relied upon for determining credit rating as required by Paragraph (a)(1)(ii)(H) of Rule 17g-7

The most important information used for the rating is:

- Audited financial statements of the last five years.
- Projections provided by the school administration of the financial statements for the next five years.
- Historical and projected data of enrollment by grade and by campus.
- Legal documentation of the bond (Trust Indenture, Loan Agreement, Supplemental Master Indenture)
- Information obtained from the school management of future strategies of enrollment, financial administration, expansion plans and improvement in academic performance.
- Public information related to state legislation, academic performance and demographic trends and competition.
- The new market tax credit is not considered for the total debt calculation, since it is considered more as a fiscal strategy and it has its counterpart as a note receivable in the assets of the School, this due to the loan made by the School. At the end of the operation the School will be the holder of the complete note payable, and the loan will be eliminated from the consolidated financial statements.

9. Overall assessment of quality of information available and considered in determining credit rating as required by Paragraph (a)(1)(ii)(I) of Rule 17g-7

The quality of the information provided by the entity is considered to be consistent with the quality observed in ratings that use a similar methodology.

10. Information relating to conflicts of interest as required by Paragraph (a)(1)(ii)(J) of Rule 17g-7

The rating was solicited by the entity or issuer, or on its behalf, and therefore, HR Ratings has received the corresponding fees for the rating services provided. The following information can be found on our website at www.hrratings.com: (i) The internal procedures for the monitoring and surveillance of our ratings and the frequency with which they are formally updated, (ii) the criteria used by HR Ratings for the withdrawal or suspension of the maintenance of a rating, and (iii) the procedure and process of voting on our Analysis Committee.

11. Explanation or measure of potential volatility to the credit rating as required by Paragraph (a)(1)(ii)(K) of Rule17g-7

The main factors that could lead to the volatility of the rating are:

- **Inability to meet enrollment and ADA targets:** If the school is not able to follow their expansion plans and this results in the inability to reach the enrollment projections incorporated in our base or stress scenario that could lead to a decrease in the rating due to the fact that enrollment is vital to determine the federal and state funding that the school receives. This combined with a lower Average Daily Attendance (ADA) than the requested from the TEA. We understand that there have been temporary adjustments in order to reduce the impact that COVID-19 may have in the ADA, but in case once the minimum ADA is required and is not achieved by the Company, the rating may be impacted

- **Changes in state funding levels, or statutory changes in state open-enrollment charter School funding:** In line with the above, if the state or federal funds are in lower levels derived from a lower enrollment, it would affect the revenues the School received. Similarly, if there's a modification in the criteria that determines the levels of funding that the charter schools receive may result in the deterioration of financial metrics.

- **Changes in the strategy of debt issuance:** In order to elaborate financial projections HR Ratings makes some assumptions of the debt issuance policy of the entity taking into consideration guidance given by the school. Levels of debt are essential to determine the credit rating of the entity, therefore if levels of debt issuance changes from what HR Ratings expected in either scenario, the credit rating may also change.

- **Failure to meet financial projections in base or stress scenarios that could lead to a change in Free Cash Flow levels:** In case of suffering any deviation in the financial projections, the metrics calculated would also change and therefore the rating may also change.

- **Revocation or non-renewal of the academy's charter:** One of the main qualitative risks is the revocation of the charter as a result of different reasons. The most important would be a considerable deterioration of students' academic performance. This would result in the suspension of operations of the charter and very likely in the default of their obligations.

12. Historical performance and expected probability of default and expected loss in event of default as required by Paragraph (a)(1)(ii)(L) of Rule 17g-7

For historical performance of each rating listed in the disclosure form, click on the link in the ratings table presented on Page 1.
Our credit ratings need to be understood as rankings of the relative creditworthiness of different entities or credits. Creditworthiness takes into consideration both the ability and willingness to meet debt obligations in the manner prescribed in the relevant documentation. Default refers to the noncompliance of previously agreed obligations.

As our ratings measure relative creditworthiness, they do not necessarily reflect any specific statistical probability of default. In order to make more valid rankings of creditworthiness our different methodologies will apply stress case scenarios to complement our base case analysis.

13. Assumptions made by HR Ratings in determining announced credit ratings and examples of how assumptions impact the rating as required by Paragraph (a)(1)(ii)(M) of Rule 17g-7

Assumptions:

- **Growth of Revenue:** It is expected that the School will continue with the upward trend in its total revenues, with a CAGR of 7.3% for the projected period of 2019-2024. This mainly driven by a conservative growth in 2021, followed by a bigger increase in 2022 after most of the classes has been regularized and the Mesquite Campus would be able to reflect the expected impact.

- **State Legislation:** We assume that the legislation that allows Charter Schools to operate will not have any change that could generate trouble in the operation of the school or to the revocation of the charter.

- **Debt Issuance Policy:** HR Ratings assumes that the school management will follow the policy of debt issuance, in order of not having changes in the financial projected metrics.

- **PPP Loan Forgiveness:** During FY20 the school obtained a Paycheck Protection Program Loan with the SBA for US$4.6m, this loan has been already used under the specific terms and conditions so it can be treated as a forgivable loan and the school has applied for this forgiveness. We do not consider that this loan would be paid.

- **Expansion Plans:** It is considered that the school will be able to meet the expansion plans in order to reach the enrollment numbers incorporated in the financial model.

- **Academic Performance:** The school will be able to maintain the academic performance required by the regulation to keep the charter license once the TEA accounting tests return to regular appliance.

14. Representations, warranties and enforcement mechanisms available to investors as required by Paragraph (a)(1)(ii)(N) of Rule 17g-7

The reporting of representations, warranties, and enforcement mechanisms does not apply to any of the credit ratings listed in this disclosure form.

Credit Rating Attestation

I, José Luis Cano, Corporates / ABS Executive Director have the responsibility for this rating action and, to the best of my knowledge:

- No part of the credit rating was influenced by any other business activities;
- The credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated; and
- The credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument

Mexico City, December 31st, 2020

/s/ José Luis Cano, Corporates Executive Director / ABS

/s/ José Luis Cano
Corporates / ABS Executive Director
HR Ratings de México, S.A. de C.V.

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The rating was solicited by the entity or issuer, or on its behalf, and therefore, HR Ratings has received the corresponding fees for the rating services provided. The following information can be found on our website at www.hrratings.com: (i) The internal procedures for the monitoring and surveillance of our ratings and the periodicity with which they are formally updated, (ii) the criteria used by HR Ratings for the withdrawal or suspension of the maintenance of a rating, and (iii) the procedure and process of voting on our Analysis Committee.

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HR Ratings bases its ratings and/or opinions on information obtained from sources that are believed to be accurate and reliable. HR Ratings, however, does not validate, guarantee or certify the accuracy, correctness or completeness of any information and is not responsible for any errors or omissions or for results obtained from the use of such information. Most issuers of debt securities rated by HR Ratings have paid a fee for the credit rating based on the amount and type of debt issued. The degree of creditworthiness of an issue or issuer, opinions regarding asset manager quality or ratings related to an entity’s performance of its business purpose are subject to change, which can produce a rating upgrade or downgrade, without implying any responsibility for HR Ratings. The ratings issued by HR Ratings are assigned in an ethical manner, in accordance with healthy market practices and in compliance with applicable regulations found on the www.hrratings.com rating agency webpage. There Code of Conduct, HR Ratings’ rating methodologies, rating criteria and current ratings can also be found on the website.

Ratings and/or opinions assigned by HR Ratings are based on an analysis of the creditworthiness of an entity, issue or issuer, and do not necessarily imply a statistical likelihood of default, HR Ratings defines as the inability or unwillingness to satisfy the contractually stipulated payment terms of an obligation, such that creditors and/or bondholders are forced to take action in order to recover their investment or to restructure the debt due to a situation of stress faced by the debtor. Without disregard to the aforementioned point, in order to validate our ratings, our methodologies consider stress scenarios as a complement to the analysis derived from a base case scenario. The rating fee that HR Ratings receives from issuers generally ranges from US$1,000 to US$1,000,000 (or the foreign currency equivalent) per issue. In some instances, HR Ratings will rate all or some of the issues of a particular issuer for an annual fee. It is estimated that the annual fees range from US$5,000 to US$2,000,00 (or the foreign currency equivalent).