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Itineris Early College High School, Utah; Charter Schools

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Itineris Early College High School, Utah; Charter Schools

Credit Profile

US\$0.0 mil ICR due 01/01/2099

Long Term Rating

BB/Stable

New

Rationale

S&P Global Ratings assigned its 'BB' issuer credit rating (ICR) to Itineris Early College High School, Utah. The outlook is stable.

The ICR reflects our opinion of the obligor's overall capacity and willingness to meet its financial obligations, and is not specific to any particular bond series.

We assess Itineris' enterprise profile as adequate, characterized by a trend of fluctuating demand as seen in its enrollment, which we believe could soon stabilize near facility capacity; excellent academics; and a stable management team. The school's reputation as one of the best high schools in the state supports our favorable opinion of its demand profile, which translates to our opinion of the school's overall enterprise profile. We assess Itineris' financial profile as vulnerable, with a high debt burden relative to its limited operations, slim margins, and a satisfactory cash position for the rating category. In our view, the financial profile is constrained by the organization's small operating base relative to debt outstanding. Combined, we believe these credit factors lead to an indicative stand-alone credit profile of 'bb' and a final long-term rating of 'BB'.

The 'BB' rating reflects our assessment of the school's:

- High debt burden, coupled with negative unrestricted net assets (UNA);
- Small operating base, with less than \$5 million in annual operating revenue;
- Maximum annual debt service (MADS) coverage levels that have historically been less than 1.5x; and
- Risk, as with all charter schools, that it can be closed for nonperformance of its charter or for financial distress before final maturity of the bonds.

In our opinion, the preceding credit factors are partially mitigated by the school's:

- Stable operations with more than 15 years of operational performance, an evergreen charter, solid student retention, and excellent academics;
- Improving cash levels, with 54 days' cash on hand based on fiscal 2018 audited financial statements; and
- Consistent financial performance with at least break-even operations projected in fiscal 2019.

As of fiscal 2018 year-end, Itineris' total debt consisted of the organization's series 2013 bonds with about \$8 million

outstanding. The school used series 2013 bond proceeds to build and construct its current facility, and it launched operations at the facility in the fall of 2014.

Itineris Early College High School is a single-site, grade 10-12 charter school. The charter school began operations in the fall of 2004 with only 85 students in grade 11, and added grade 12 the following fall. Today, Itineris serves about 400 students in grades 10 through 12. The school's initial charter was granted by the Jordan School District in 2004. In 2013, Itineris requested, and was granted, a change in its chartering entity to the Utah State Charter School Board from the school district, and currently operates under that charter agreement. The charter automatically renews each year unless terminated by the state board. The charter school maintains a unique partnership with Salt Lake Community College (SLCC), and provides college-level courses through SLCC's concurrent enrollment program.

Outlook

The stable outlook reflects our expectation that, during the next year, Itineris' demand profile will continue to reflect excellent academics and the school will maintain at least its current enrollment levels. The outlook also reflects our view that the school will maintain positive, albeit slim, operations on a full-accrual basis and sustain MADS coverage and liquidity at levels consistent with those of peers and medians at the current rating.

Downside scenario

We could consider lowering the rating if operations produce negative operating margins, causing liquidity to significantly weaken from current levels, or if MADS coverage declines from historic results. In addition, we would view negatively a decline in enrollment or other demand metrics.

Upside scenario

We could raise the rating over the long term if the school's financial profile, including MADS coverage, days' cash on hand, UNA, and debt burden were to improve to levels we consider consistent with those of its higher-rated peers and the school demonstrated its ability to sustain enrollment levels closer to its cap of 415.

Enterprise Profile

Economic fundamentals

Itineris is in Salt Lake County, about 20 miles south of Salt Lake City. The county's minor population is healthy, at about 431,000, and is expected to remain fairly stable, with projections indicating a steady increase of 1.7% over the next five years.

Industry risk

Industry risk addresses the charter school sector's overall cyclical and competitive risk and growth by applying various stress scenarios and evaluating barriers to entry, levels and trends of profitability, substitution risk, and growth trends observed in the industry. We believe the charter school sector represents a moderately high credit risk when compared with other industries and sectors.

Market position

We view the school's enrollment and demand profile as acceptable despite year-over-year changes in enrollment. Total enrollment has fluctuated over the past three years, but has averaged around 400. In the fall of 2018, it fell to 372 from 404 in fall 2017, which was up from 386 in the fall of 2016. Given current registration counts, we believe fall 2019 enrollment will be 425. Based on conversations with management, we attribute the increase to a growing brand recognition. Also, the fall of 2019 marks the first time that school maintained a waitlist. While only containing 44 students, or about 10% of total enrollment, we believe the waitlist should allow the school to maintain enrollment at more than 400 during the 2019-2020 school year; however, our rating takes into account that enrollment has historically been under 400. The school's retention rates have averaged about 90% over the past three years, which we view positively. The charter school has an enrollment cap of 415, which limits future enrollment growth, and the small size of the school could lead to continued fluctuations. Should enrollment be sustained at more than 400 and the school's waitlist increase over time, our view of its demand and competition profile could improve, but that is unlikely over the outlook period.

While we typically view the Salt Lake City area as an increasingly competitive market due to continued population and economic growth, we believe Itineris' early college high school program, which is one of six in the state, is unique to its service area and its impressive academic programs should allow it to maintain its competitive market share. For more than five years, Itineris' standardized test scores have outperformed state and national averages, which we view as a positive credit factor, and has consecutively been named as one of America's best high schools, according to "U.S. News and World Report." Within the service area, we believe there are three district high schools and one charter school, but those schools' programs are unlike Itineris' rigorous academic program or unique course offerings. As a result, we believe it will maintain its good market share over the next few years.

We view the school's charter standing and relationship with the authorizer as very good. Charter contracts in Utah do not expire or require renewal; they perpetuate indefinitely unless revoked. Itineris has held its charter with the Utah State Charter School Board since 2013. The statutory framework assessment reflects our opinion that, while there might be some areas of risk, the framework is not likely to impair the school's future ability to pay debt service.

We view the state funding environment in Utah as healthy. State per-pupil funding has been increasing and was \$7,962 per student for fiscal 2018, compared with \$7,370 for the previous school year. In fiscal 2019, we believe per-pupil funding improved to \$8,557, and could increase to about \$9,071 in fiscal 2020. Based on conversations with management, we believe the education funding environment in Utah is stable and we expect per-pupil funding will increase modestly in the next few years.

Management and governance

Itineris' senior management team and board of directors have been stable for the past few years. Under the school's bylaws, the board consists of no fewer than five and no greater than seven trustees. It holds regularly scheduled board meetings, typically once every other month. Itineris has a contract with Charter Solutions Inc. to provide financial, administrative, and other business management services. In our view, the board remains active in assessing the school's long-term goals and applying solutions to meet them. Itineris has set a high academic standard that continues to strengthen its overall profile in the market. Management oversees financial operations acceptably. We view management as solid and anticipate no changes in the next few years.

Financial Profile

Financial performance

The school's financial performance can be characterized by good EBIDA margins, but modest coverage, which should continue given the school's limited capacity for revenue growth. For the fiscal year ended June 30, 2018, the school produced an EBIDA margin of 23.8%, or about \$853,000, translating into 1.3x MADS coverage. Year-end EBIDA margins were similar to the past two years at \$778,000 (23.4%) in fiscal 2017, and \$730,000 (22.9%) in fiscal 2016. Historically, operating margins have been about break-even on a full-accrual basis, with the school producing surplus operations of \$101,000, or a 2.8% margin, on a full-accrual basis in fiscal 2018. In fiscal years 2017 and 2016, margins were \$21,000 (0.6%), and negative \$44,000 (negative 1.4%).

Based on the current debt service schedule on the unrated series 2013 bonds, debt service is fairly level throughout the life of the bonds, but MADS occurs in fiscal 2037 and is about \$654,000. Over the past three years, MADS coverage has ranged from 1.1x-1.3x. We believe Itineris will achieve break-even operations on a full-accrual basis in fiscal 2019, based on year-to-date budget-to-actuals, which should allow MADS coverage to align with historical results. We view the school's operations as somewhat limited by an overall revenue base of less than \$4 million, coupled with it operating near capacity. As a result, we do not anticipate the organization's operating base will increase materially in the near term; however, we understand that the school is looking into options to refinance its current debt outstanding. If it successfully refinanced the series 2013 bonds, we believe that annual debt service could be reduced by about \$200,000, which could improve lease-adjusted MADS coverage to about 1.8x (based on fiscal 2018 results).

Liquidity and financial flexibility

We consider the school's balance sheet modest for the 'BB' rating. The school's liquidity position has experienced stable growth over the past three years. As of fiscal year-end 2018, it had 54 days' cash on hand. This is an increase from the about 36 days' cash on hand in fiscal 2016. Management reports that it currently has no significant plans to draw down its cash position. We expect continued positive operating performance should assist the school in increasing its liquidity.

Itineris' unrestricted reserves as a percentage of debt for fiscal 2018 was 6.1%, which we view as very weak for the rating. Furthermore, the school's UNA remains poor for the rating category. In fiscal 2018, the UNA position was negative \$325,000, which, in our view, further constrains the rating at the 'BB' category. While the school's UNA position is negative, it has improved over the past three years as it was negative \$420,000 in fiscal 2016. We expect, as the debt liability is reduced and the school continues to produce modest surpluses, the unrestricted net position should improve over the next few years.

Debt burden

At year-end fiscal 2018, the school had about \$8 million of debt outstanding. This translates into a high debt burden of about 18.8% compared to revenue, or 12.9% on a pro forma basis if the school is able to refinance its debt based on current market conditions. Itineris has no additional contingent liabilities or off-balance-sheet debt. While we view the school's debt burden as high for the rating, and we understand it has no plans to take on additional debt, which should allow debt ratios to moderate over time. Overall, we believe the school's burden will remain very weak over the next

several years because the facility's capacity prevents growth, and therefore significant increases in revenue.

As with many charter schools, the organization's debt-to-capitalization ratio shows significant leverage on Itineris' balance sheet. For fiscal 2018, the debt-to-capitalization ratio was 104.5%, and it has remained high over the past three years. We view the school's debt burden as a significant constraining factor to the rating, and we expect minimal improvement in these ratios over the next few years.

Financial policies

The school has formal policies for liquidity and debt that are in line with bond covenants. Itineris meets standard annual disclosure requirements. The financial policies assessment reflects our opinion that, while there might be some areas of risk, the organization's overall financial policies are not likely to impair Itineris' future ability to pay debt service. Our analysis of financial policies includes a review of the organization's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure, and a comparison of these policies to those of similar providers.

Itineris Early College High School, Utah: Enterprise and Financial Statistics						
	--Fiscal year ended June 30--					Medians for 'BB' rated charter schools
	2020	2019	2018	2017	2016	2018
Enrollment						
Total headcount	425	372	404	386	407	956
Total waiting list	44	N.A.	N.A.	N.A.	N.A.	MNR
Waiting list as % of enrollment	10.4	N.A.	N.A.	N.A.	N.A.	22.6
Financial performance						
Accounting standard	N.A.	N.A.	FASB	FASB	FASB	N.A.
Total revenues (\$000s)	N.A.	N.A.	3,581	3,326	3,191	9,039
Total expenses (\$000s)	N.A.	N.A.	3,480	3,305	3,235	MNR
EBIDA (\$000s)	N.A.	N.A.	853	778	730	MNR
EBIDA margin (%)	N.A.	N.A.	23.8	23.4	22.9	14.3
Excess revenues over expenses (\$000s)	N.A.	N.A.	101	21	(44)	MNR
Excess income margin (%)	N.A.	N.A.	2.8	0.6	(1.4)	2.3
Lease adjusted annual debt service (\$)	N.A.	N.A.	658	652	658	MNR
Lease-adjusted annual debt service coverage (x)	N.A.	N.A.	1.30	1.19	1.11	MNR
Lease-adjusted annual debt service burden (% total revenues)	N.A.	N.A.	18.4	19.6	20.6	MNR
MADS (\$000s) (change to Lease adjusted MADS)	N.A.	N.A.	654	658	658	1,324
Lease-adjusted MADS coverage (x)	N.A.	N.A.	1.30	1.18	1.11	1.20
Lease-adjusted MADS burden (% total revenues)	N.A.	N.A.	18.3	19.8	20.6	13.6
Pro forma MADS (\$000s)	N.A.	N.A.	463	N.A.	N.A.	MNR
Pro forma lease-adjusted MADS coverage (x)	N.A.	N.A.	1.84	N.A.	N.A.	MNR
Pro forma lease-adjusted MADS burden (% total revenues)	N.A.	N.A.	12.9	N.A.	N.A.	MNR

Itineris Early College High School, Utah: Enterprise and Financial Statistics (cont.)

	--Fiscal year ended June 30--					Medians for 'BB' rated charter schools
	2020	2019	2018	2017	2016	2018
Total revenue per student (\$)	N.A.	N.A.	8,863.9	8,616.6	7,840.3	MNR
Balance sheet metrics						
Unrestricted reserves (\$)	N.A.	N.A.	490	316	301	MNR
Days' cash on hand	N.A.	N.A.	54.28	37.05	36.32	72.00
Total long-term debt (\$000s)	N.A.	N.A.	8,001	8,106	8,203	MNR
Unrestricted reserves to debt (%)	N.A.	N.A.	6.4	4.0	3.7	11.9
Unrestricted net assets as % of expenses	N.A.	N.A.	(9.9)	(12.8)	(13.9)	17.2
Debt to capitalization (%)	N.A.	N.A.	104.5	105.5	105.5	91
Debt per student (\$)	N.A.	N.A.	18,822	19,953	19,912	16,811
Pro forma metrics						
Pro forma unrestricted reserves (\$000s)	N.A.	N.A.	490	N.A.	N.A.	MNR
Pro forma days' cash on hand	N.A.	N.A.	54	N.A.	N.A.	MNR
Pro forma long-term debt (\$000s)	N.A.	N.A.	8,006	8,106	8,203	MNR
Pro forma unrestricted reserves to debt (%)	N.A.	N.A.	6.1	N.A.	N.A.	MNR
Pro forma debt to capitalization (%)	N.A.	N.A.	104	105	105	MNR
Pro forma debt per student (\$)	N.A.	N.A.	19,817	21,000	20,155	MNR

N.A.--Not available. N/A--Not applicable. MNR--Median not reported. MADS--Maximum annual debt service. Operating lease expense--Annual amount paid in facilities/capital lease payments; excludes equipment/nonfacility lease payments and excludes payments related to principal and interest on bonds. Net revenue available for debt service = EBIDA+operating lease expense. Lease-adjusted MADS coverage = (Net revenue available for debt service + operating lease expense) / (Lease-adjusted MADS). Total expenses include pension and OPEB adjustments. Pension and OPEB adjustments= reconciling adjustments made to financial information to account for differences in GASB 68 and GASB75.

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