

James Irwin Charter Schools, Colorado; Charter Schools

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James Irwin Charter Schools, Colorado; Charter Schools

Credit Profile

ICR

Long Term Rating

BBB/Stable

New

Rationale

S&P Global Ratings assigned its 'BBB' issuer credit rating (ICR) to James Irwin Charter School (JICS), Colo. The outlook is stable.

An ICR reflects the obligor's general creditworthiness, focusing on its capacity and willingness to meet financial commitments when they come due. It does not apply to any specific financial obligation because it does not take into account the obligation's nature and provision, standing in bankruptcy or liquidation, statutory preferences, or legality and enforceability.

We assessed JICS' enterprise profile as strong, based on its relatively large enrollment size; long operating history supported by solid academics; and good management practices and planning, which we expect to continue even with the planned retirements of the CEO and CFO in 2020 and 2021, respectively. We assessed the financial profile as adequate, with solid lease-adjusted maximum annual debt service (MADS) coverage despite some pension pressures from the state's low funded plan, and healthy days' cash on hand and operating performance metrics, and solid MADS burden for the rating. We believe that these combined credit factors lead to an indicative stand-alone credit profile of 'bbb' and a final rating of 'BBB' for JICS.

The rating reflects our view of JICS':

- Relatively large enrollment size of almost 2,000 students for fall 2018, with the capacity to serve more than 2,100 students;
- History of healthy operating surpluses, with a full-accrual surplus of \$2.1 million in fiscal 2018 after adjusting for accrued pension expenses, and another healthy surplus projected for fiscal 2019; and
- Healthy liquidity position with days' cash on hand that is moderately higher than similarly rated peers' at 217 days in fiscal 2018, with no plans to draw down reserves in fiscal 2019; and
- Manageable debt levels with MADS burden at 9.3%.

Partially offsetting the above strengths, in our view, are JICS':

- Increased competition in the area, which could constrain demand metrics over the outlook horizon;
- Future capital plans totaling about \$5 million before the end of fiscal 2021, once Power Technical Early College (PTEC) enrollment is at 325 students, to support the school's advanced shops capital project; and

- Potential, as with all charter schools, that the charter could be revoked before the loan's final maturity.

Following the closing of the series 2019 loan, JICS' only debt will be the series 2019 loan (approximately \$25 million). Officials will use loan proceeds to refinance the school's existing series 2015 and series 2016 notes for savings and a fixed interest rate over a 30-year amortization period. The series 2015 and series 2016 notes were used to refinance prior debt and fund the construction of PTEC. JICS' series 2019 loan is secured solely by the lease payments and a gross revenue pledge of all five schools that comprise JICS and a first-priority deed of trust on all real property of the borrower (JICS). Loan provisions include a pledge to maintain liquidity equal to 60 days' cash on hand and an annual debt service covenant of 1.1x.

Outlook

The stable outlook reflects our expectation that over the next two years, JICS will sustain a steady financial profile by continuing to generate positive operating performance on a full-accrual basis and maintain its healthy cash position despite a capital plan at its PTEC campus. We also expect the school's demand profile, academic quality, and management team to remain stable, and for enrollment to continue to grow toward the school's capacity of about 2,100.

Upside scenario

We could raise the rating if enrollment remains stable and demand strengthens, as demonstrated through growth in the waitlist, and if JICS demonstrates a trend of stronger MADS coverage and days' cash on hand that is more consistent with a higher rating category, while maintaining its enrollment and demand profile.

Downside scenario

We could lower the rating if enrollment declines, operations produce deficits, MADS coverage weakens, or liquidity falls below levels we view as being in line with the rating due to additional debt plans, although no planned drawdowns in reserves are expected.

Enterprise Profile

Economic fundamentals

JICS is in Colorado Springs within El Paso County. The county's minor population is healthy at about 247,000 and is projected to grow steadily by 2.7% over the next five years.

Industry risk

Industry risk addresses our view of the charter school sector's overall cyclicality and competitive risk and growth through application of 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

JICS' mission to provide students with the skills to enter college or the workforce is grounded in a college preparatory curriculum centered on character. JICS composed of five schools on three campuses:

- James Irwin Elementary School (JICES; grades K-5);
- James Irwin Middle School (JICMS; grades 6-9);
- James Irwin High School (JICHS; grades 9-12);
- James Irwin Charter Academy(JICA; grades K-5), and
- Power Technical Early College (PTEC; grades 6-14; grades 13-14 reflect the opportunity to pursue an associate's degree through a local community college tuition-free at PTEC).

JICS' enrollment continues to move toward the school's capacity of about 2,100 for the second straight year, with enrollment near 2,000 in fall 2018 after steady increases. The school's fall 2018 waitlist had 800 students, which, while improved over the past three years, remains somewhat low in relation to the enrollment size it has to support, at 40%. Officials project enrollment to remain consistent with fall 2018 levels in fall 2019. JICS continues to exceed state academic standards and meets or exceeds those of local districts, with the exception of PTEC, which only recently opened in 2017. We view PTEC's goal of providing students a chance to enter the workforce following the opportunity to master a trade, coupled with the potential to stay with PTEC after 12th grade and earn a tuition-free associate's degree, as favorable marketing factors that will continue support JICS' healthy demand trends. Officials have implemented a self-imposed improvement plan to help bring the new school up to JICS' traditionally rigorous academic standard, which includes numerous John Irwin Blue Ribbons, as well as favorable U.S. News and World Report and Washington Post rankings.

JICS has three authorizers. Harrison School District No. 2 authorizes JICES, JICMS, and JICHS, which account for about 71% of JICS students. The district renewed the JICS charter in 2004 for 30 years. JICA's (enrollment 334) charter was renewed by the Charter School Institute in 2018 for five years. PTEC was initially authorized for five years in 2016; PTEC's fall enrollment was about 240 students. While we weigh our opinion more on the Harrison School District No. 2 authorizer, we view JICS' authorizer relationships as good.

The statutory framework assessment reflects our opinion that despite areas of risk, the framework is not likely to hamper the school's ability to pay debt service. We consider state funding to be stable, with moderate funding increases over the past couple of years. State funding in Colorado has increased year-over-year for the past eight fiscal years, and the school anticipates that fiscal 2020 will see a 4.4% increase in per pupil funding. In our opinion, the increase in per pupil funding for kindergarten students from 0.58x full-time equivalent (FTE) to 1.00x FTE will materially support healthy margins for schools such as JICs. We believe the steady increases in state funding have helped support operations at the school in that it allows for more predictable budgetary planning.

Management and governance

Our view of management is favorable. Despite the planned retirements of the CEO and CFO in 2020 and 2021, respectively, the board and management have instituted succession plans that are married to the JICS' dynamic strategic plan to ensure tenured internal leaders are groomed and ready to step in following a lengthy and

comprehensive onboarding and transition process. We expect the transitions to be smooth over the outlook horizon, given the formal policies and practices cascaded throughout the organization.

The board is stable and is composed of professionals from various sectors. It consists of eight members following routine turnover related to term limits. We view the board's relationship with management as favorable given the school's approximately 20-year operating history with demonstrated success along both academic and operational lines.

Financial Profile

We analyze the materiality, strategy, and funding of pension plans separately from our analysis of a school's long-term debt ratios or operating margin. Consequently, we might make certain adjustments to the calculation of debt ratios or operating margins for schools with substantial multiple-employer, cost-sharing defined benefit pension plans to separate out the net pension liability or noncash expense accrual. In our view, these adjustments enhance analytical clarity from a credit perspective and result in more comparable debt and operating metrics across accounting methods.

Financial performance

After adjusting for noncash pension expenses, JICS posted full-accrual operating surpluses for the past three fiscal years. Fiscal 2018's operations were positive at 12.99%, resulting in pro forma MADS coverage of 1.8x. Based on management's projections for fiscal 2019, we anticipate coverage will remain in line with that of peers following another year of solid excess margins based on projections and healthy year-to-date results.

Liquidity and financial flexibility

As of fiscal 2018, JICS' liquidity position remains higher than that of similarly rated peers for the third consecutive year, with 217 days' unrestricted cash on hand. Unrestricted reserves to debt is sufficient at 31.4%. Officials have historically outperformed their budget and have no plans to draw down reserves in fiscal 2019. In our view, JICS' liquidity should remain well in line with the rating level given the school's limited capital plans and healthy projected operating margins.

Debt burden

The school's MADS burden is 9.3% of revenue as of fiscal 2018, which we consider slightly above average for the rating. Officials plan to add \$5 million of additional debt if PTEC enrollment increases by about 85 students to fund a project to construct advanced workshops for PTEC students in fiscal 2021. Despite the potential for additional debt near the end of the outlook horizon, we expect the school's debt burden to remain in line with that of similarly rated peers given the state's healthy per-pupil funding environment.

JICS participates in the school division trust fund administered by the Public Employees Retirement Association of Colorado. Currently, the school's proportionate share of the plan is underfunded at about 44% based on the Dec. 31, 2017, measurement date, which at that level we consider to be an elevated unfunded obligation. The state recently adopted pension reform in its 2018 legislation session, which, in our view, should be sufficient to prevent further decline of the funded ratios within the outlook period. Management continues to make 100% of its statutorily

determined contributions, which were 9.3% of total expenses in fiscal 2018. We will continue to monitor the funding effect on the school's budget should contribution requirements increase significantly.

Financial policies

JICS meets standard annual disclosure requirements. The financial policies assessment reflects our opinion that, despite areas of risk, the organization's overall financial policies are not likely to hamper its 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 with those of similar providers.

James Irwin Charter School, Colorado

Enterprise and financial statistics

	--Fiscal year ended June 30--				Medians for 'BBB' rated charter schools
	2019	2018	2017	2016	2018
Enrollment					
Total headcount (no.)	1,982	1,983	1,900	1,722	2,354
Total waitlist (no.)	800	667	527	N.A.	MNR
Waitlist as % of enrollment	40.4	33.6	27.7	N.A.	51.3
Financial performance					
Total revenues (\$000s)	N.A.	16,465	15,243	13,179	25,383
Total expenses (\$000s)	N.A.	14,327	14,262	12,353	MNR
EBIDA (\$000s)	N.A.	2,744	2,513	1,920	MNR
EBIDA margin (%)	N.A.	16.7	16.5	14.6	15.8
Excess revenues over expenses (\$000s)	N.A.	2,138	981	826	MNR
Excess income margin (%)	N.A.	13.0	6.4	6.3	6.3
Operating lease expense	N.A.	N.A.	N.A.	N.A.	MNR
Lease-adjusted annual debt service coverage (x)	N.A.	1.68	1.59	1.83	MNR
Lease-adjusted annual debt service burden (% total revenues)	N.A.	9.9	10.3	8.0	MNR
MADS (\$000s)	N.A.	1,632	N.A.	N.A.	2,153
Lease-adjusted MADS coverage (x)	N.A.	1.68	N.A.	N.A.	1.90
Lease-adjusted MADS burden (% total revenues)	N.A.	9.9	N.A.	N.A.	8.4
Pro forma MADS (\$000s)	N.A.	1,526	1,526	1,526	MNR
Pro forma lease-adjusted MADS coverage (x)	N.A.	1.80	1.65	1.26	MNR
Pro forma lease-adjusted MADS burden (% total revenues)	N.A.	9.3	10.0	11.6	MNR
Total revenue per student (\$)	N.A.	8,303.1	8,022.6	7,653.3	MNR
Balance-sheet metrics					
Days' cash on hand	N.A.	217.10	202.59	199.41	181.80
Total long-term debt (\$000s)	N.A.	25,981	26,525	24,122	MNR
Unrestricted reserves to debt (%)	N.A.	31.4	28.7	27.2	42.6
Unrestricted net assets as % of expenses	N.A.	40.4	44.7	44.9	60.0
General fund balance (\$000s)	N.A.	6,973	6,231	5,307	MNR

James Irwin Charter School, Colorado (cont.)

Enterprise and financial statistics

	--Fiscal year ended June 30--				Medians for 'BBB' rated charter schools
	2019	2018	2017	2016	2018
Debt to capitalization (%)	N.A.	82.1	80.9	81.3	67
Debt per student (\$)	N.A.	12,796	13,653	13,661	11,482
Pro forma metrics					
Pro forma unrestricted reserves (\$000s)	N.A.	N.A.	N.A.	N.A.	MNR
Pro forma days' cash on hand	N.A.	N.A.	N.A.	N.A.	MNR
Pro forma long-term debt (\$000s)	N.A.	25,981	26,525	24,122	MNR
Pro forma unrestricted reserves to debt (%)	N.A.	N.A.	N.A.	N.A.	MNR
Pro forma debt to capitalization (%)	N.A.	82	81	82	MNR
Pro forma debt per student (\$)	N.A.	13,102	13,961	14,008	MNR

N.A.--Not available. 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. Lease-adjusted MADS coverage = (Net revenue available for debt service + operating lease expense) / (MADS + operating lease expense).

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