Arlington Classics Academy, Texas Arlington Higher Education Finance Corp.; Charter Schools

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Credit Profile		
Arlington Classics Academy ed rev bnds ser 2016A dtd 02/01/2016 due 08/31/2045		
Long Term Rating	BBB-/Stable	Upgraded
Arlington Classics Academy taxable ed rev bnds ser 2016B due 08/31/2025		
Long Term Rating	BBB-/Stable	Upgraded

Rationale

S&P Global Ratings raised its rating to 'BBB-' from 'BB+' on Anson Education Facilities Corp., Texas' series 2016A education revenue bonds and series 2016B taxable education revenue bonds issued for Arlington Classics Academy (ACA), as well as the series 2010A, B, and C bonds. The outlook is stable.

The upgrade reflects our view of ACA's consistent operating surpluses with coverage and liquidity measures that are in line with the higher rating.

We assessed ACA's enterprise profile at adequate characterized by the school's continued growth in enrollment and demand profile, high-quality academic performance, and solid management and governance with strategic planning to guide achievement. We assessed ACA's financial profile at adequate based on a trend of solid debt service coverage (DSC) and robust liquidity, but an elevated debt per student figure and potential expansion plans to add grades 10-12, which are on hold until additional facilities and funding are identified. We believe that combined, these credit factors lead to an indicative stand-alone credit profile of 'bbb-' and a final rating on the bonds of 'BBB-'.

The rating further reflects our view of the charter school's:

- Maximum annual debt service (MADS) coverage of 1.74x based on 2017 audited financials;
- Solid enrollment growth to 1,534 for fall 2017 with more demand as evidenced by a wait list of 567 and retention rate of 94%;
- Robust liquidity, with 173 days' cash on hand at fiscal 2017 year-end; and
- Meaningfully stronger student test scores relative to the district and state.

Partly offsetting factors, in our opinion, include:

- Expansion risks associated with potential future plans to grow into the grade 10-12 levels which are currently on hold, including risks of not achieving high-quality academics, or not maintaining steady enrollment, which could worsen overall financial health;
- Elevated MADS burden as a percentage of 2017 revenue of 15.5 %; and

- Inherent risks associated with charter schools, including the possibility that the charter may not be renewed or may be revoked prior to the maturity of the bonds.

Bond proceeds for the series 2016 bonds was used mainly for the construction of a new 35,000-square-foot facility at the Arkansas Campus, along with other minor capital improvements, to fund a debt service reserve fund, and to pay the costs of issuance. The series 2016 bonds are on parity with the series 2010 bonds. Aggregate debt service is relatively level, and MADS is $1.925 million in 2024. Per bond documents, the school is required to maintain a MADS coverage of 1.1x and 45 days' of expenses in liquidity, although failure to achieve these would not result in an event of default, only the hiring of an independent management consultant. Failure to achieve 1.0x DSC, however, may constitute in an event of default.

ACA currently operates three buildings at two sites: Arkansas Lane Campus, which serves students in grades K-2 in one building and grades 3-5 in another, and Bowen Road Campus, which serves grades 6-9.

Outlook

The stable outlook reflects our view that the school will maintain its good demand profile and commendable academic performance. We further expect that the school will build financial stability and that management will take a measured approach to expansion plans such that no substantial weakening of its financial profile will result should it decide to expand to grades 10-12 to complete the rest of its high school program, though no concrete plans exist currently.

Upside scenario

A higher rating relies on maintenance of its demand metrics and other enterprise characteristics, coupled with substantial and sustained strengthening of MADS coverage, margins, and liquidity to levels consistent with those of higher rated peers.

Downside scenario

We could lower the rating if demand weakens or if further plans to carry out the rest of the high school grade expansion result in a substantial weakening of financial metrics that are no longer commensurate with the rating.

Enterprise Profile

Economic fundamentals

ACA is in Tarrant County. The county's minor population is large at about 757,000 and is expected to increase at an impressive 6.4% annually through 2023.

Industry risk

Industry risk addresses the charter school sector's overall cyclicality 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

Enrollment and demand remain steady at the school with about 1,534 students in grades K-9. The wait list increased to 567 for fall 2017 from 427 in fall 2016. There remains limited competition in the area and management does not anticipate changes to the enrollment profile. Even though ACA's charter is approved for 2,044 K-12 students, it has no plans to grow rapidly. Retention has historically been high at over 95% in fiscal years 2014 through 2016, but fell to 87% in fiscal 2017, which management attributed partly to departures of students who faced difficulty adjusting to the accelerated curriculum. Retention recovered in fall 2017 to 94%.

The school started its first year of ninth grade with 15 students, but growth plans for grades 10-12 are on hold until additional facilities and funding are determined. The ninth grade is designed to continue to focus on rigorous academics, rather than pursuing students through campus-based recreational or sports teams. However, in our opinion, high school operations are quite different than elementary and middle school operations and future expansion plans are a credit risk due to the uncertainty associated with future academics and financials.

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. All campuses operate under a single charter authorized by the Texas Education Agency (TEA), which currently expires in 2023, lowering the chance of non-renewal. Charter schools in Texas rely on the state for per-pupil funding. For the next biennium, based on proposed bills by the state legislature, the state funding outlook is encouraging, according to estimates shared by management.

Management and governance

The director of business operations joined ACA in March 2016, bringing with her 15 years of experience in controller and accounting roles, including 10 years in education finance. The executive director served as director of academics prior to becoming the interim director in 2015 and assuming the role permanently, allowing for what we view as a smooth transition. ACA continues to be governed by an 11-member board of trustees.

The board is active and, along with management, develops an annual district improvement plan that outlines specific objectives in four areas: student outcomes, family outcomes, public outcomes, and operations. Each objective has a clear target, evaluation measures, action plans, timelines, persons responsible, and funding or human resource needs. The plan is reviewed or updated twice a year, and a decision-making and advisory committee designs strategies for the following year. We view the setbacks with the delayed opening of the high school as a partly offsetting factor to the organization's track record of academic and financial success, though it is still considered well-managed with no negative governance conditions.

Financial Profile

Financial performance

ACA has achieved a consistent trend of positive operations since fiscal 2013, generating surpluses ranging from 7% to 12%. Following a $1.0 million full-accrual surplus in fiscal 2017, fiscal 2017 results were again positive with a surplus of $1.1 million, or 8.7% of expenses. MADS coverage is 1.74x, which we consider good for the rating.

Liquidity and financial flexibility

Liquidity remains robust for the rating with unrestricted cash improving to $5.3 million in 2017 from $4.3 million in 2016. Accordingly, days' cash on hand is ample at 173 days at the end of fiscal 2017, up from 152 days in 2016. The school has no major plans to spend down cash and has an internal goal, as part of its district improvement plan, to maintain 90 days' cash on hand.

Debt burden

The MADS burden moderate at 15.5% of revenue. We understand there are currently no additional debt plans, but that plans to fill out the remainder of its high school (grades 10-12) may require use of cash and/or additional debt financing.

Financial policies

ACA 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 comparable providers.

Arlington Classics Academy, Texas

Enterprise and Financial Statistics

	--Fiscal year ended August 31--					**Medians for 'BBB-' rated charter schools**
	2018	2017	2016	2015	2014	2017
Enrollment						
Total headcount	1,534	1,483	1,440	1,397	1,293	1,020
Total waiting list	567	427	421	532	329	MNR
Waiting list as % of enrollment	37.0	28.8	29.2	38.1	25.4	39.7
Financial performance						
Total revenues ($000s)	N.A.	12,737	11,843	11,199	10,136	9,796
Total expenses ($000s)	N.A.	11,630	10,841	9,891	9,095	MNR
EBIDA ($000s)	N.A.	3,311	2,770	2,927	2,647	MNR
EBIDA margin (%)	N.A.	26.0	23.4	26.1	26.1	16.4
Excess revenues over expenses ($000s)	N.A.	1,107	1,002	1,308	1,041	MNR
Excess income margin (%)	N.A.	8.7	8.5	11.7	10.3	4.4
Operating lease expense	N.A.	123	114	84	N.A.	MNR
Lease-adjusted annual debt service coverage (x)	N.A.	1.68	1.70	1.97	1.84	MNR
Lease-adjusted annual debt service burden (% total revenues)	N.A.	16.0	14.3	13.6	14.2	MNR
Lease-adjusted annual debt service burden (% total expenses)	N.A.	17.6	15.6	15.4	15.8	MNR
MADS ($000s)	N.A.	1,977	1,976	1,444	1,444	1,107
Lease-adjusted MADS coverage (x)	N.A.	1.74	1.46	2.09	1.83	1.50
Lease-adjusted MADS burden (% total revenues)	N.A.	15.5	16.7	12.9	14.2	11.8

Arlington Classics Academy, Texas (cont.)

Lease-adjusted MADS burden (% total expenses)	N.A.	17.0	18.2	14.6	15.9	MNR
Total revenue per student ($)	N.A.	8,588.7	8,224.3	8,016.5	7,839.1	MNR
Balance sheet metrics						
Days' cash on hand	N.A.	172.90	152.44	141.98	128.63	143.20
Total long-term debt ($000s)	N.A.	23,675	23,995	15,780	16,015	MNR
Unrestricted reserves to debt (%)	N.A.	23.7	19.3	23.4	19.2	24.4
Unrestricted net assets as % of expenses	N.A.	29.9	25.0	21.2	17.7	33.9
General fund balance ($000s)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Debt to capitalization (%)	N.A.	86.8	89.5	88.6	91.1	83
Debt per student ($)	N.A.	14,757	15,391	11,117	12,204	13,891

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. Lease-adjusted MADS coverage = (Net revenue available for debt service + operating lease expense) / (MADS + operating lease expense)

Ratings Detail (As Of June 22, 2018)

Arlington Hgr Ed Fin Corp, Texas

Arlington Classics Academy, Texas

Arlington Hgr Ed Fin Corp (Arlington Classics Academy) CHARTERSCH

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