

RatingsDirect®

Clifton Higher Education Finance Corp., Texas Idea Public Schools; Charter Schools; School State Program

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US\$213.235 mil ed rev bnds (Idea Public Schools) ser 2019 dtd 10/15/2019 due 08/15/2039		
<i>Long Term Rating</i>	AAA/Stable	New
<i>Underlying Rating for Credit Program</i>	A-/Stable	New
Clifton Hgr Ed Fin Corp, Texas		
Idea Public Schools, Texas		
Clifton Hgr Ed Fin Corp (Idea Public Schools)		
<i>Long Term Rating</i>	AAA/Stable	Current
<i>Underlying Rating for Credit Program</i>	A-/Stable	Upgraded
Clifton Hgr Ed Fin Corp (Idea Public Schools) ed rev bnds (Idea Public Schools) ser 2015 dtd 10/01/2015 due 08/15/2045		
<i>Long Term Rating</i>	AAA/Stable	Current
<i>Underlying Rating for Credit Program</i>	A-/Stable	Upgraded
Clifton Hgr Ed Fin Corp (Idea Public Schools) CHARTERSCH		
<i>Long Term Rating</i>	AAA/Stable	Current
<i>Underlying Rating for Credit Program</i>	A-/Stable	Upgraded
Clifton Hgr Ed Fin Corp (Idea Public Schools) Ed Rev and Rfdg Bnds (Idea Public Schools) ser 2016A dtd 09/01/2016 due 08/15/2046		
<i>Long Term Rating</i>	AAA/Stable	Current
<i>Underlying Rating for Credit Program</i>	A-/Stable	Upgraded
Clifton Hgr Ed Fin Corp (Idea Public Schools) (New Campuses and Existing Campus Completion)		
<i>Long Term Rating</i>	AAA/Stable	Current
<i>Underlying Rating for Credit Program</i>	A-/Stable	Upgraded
series 2011		
<i>Long Term Rating</i>	A-/Stable	Upgraded
Series 2012 and 2013		
<i>Long Term Rating</i>	A-/Stable	Upgraded

Rationale

S&P Global Ratings raised its underlying rating and non-enhanced ratings to 'A-' from 'BBB+' on Idea Public Schools Inc. (IDEA), Texas' debt outstanding. At the same time, S&P Global Ratings assigned its 'A-' underlying rating and 'AAA' long-term program rating to Clifton Higher Education Finance Corp., Texas' series 2019 bonds issued for IDEA. The outlook on all ratings is stable.

The upgrade reflects our view of IDEA's strategic approach to charter school expansion and as well as the school's proven track record of growth while maintaining a reputation for very high academic results and solid operating

margins. The upgrade also reflects IDEA's national brand recognition, long operating history, position as the largest charter school network in the U.S. based on enrollment, and management's demonstrated ability to continue to attract significant gifts. In our opinion, IDEA maintains a very good relationship with its authorizer, Texas Education Agency (TEA), as demonstrated by multiple campuses receiving academic distinctions from the state, requests by TEA for IDEA to assist with underperforming traditional public schools, several charter renewals, annual increases in the school's enrollment cap, and a 10-year charter that extends through July 2025, we believe reflects a strong relationship between the school and its charter authorizer. While charter renewal and revocation risk is endemic to the charter sector at large, we believe the above-described factors sufficiently mitigate these risks for IDEA. We also view the school's overall financial metrics as modest for the rating level, and we believe IDEA's size, astute management team, and other highly favorable demand profile characteristics sufficiently offset financial metrics that might be lower than those of peers in some areas.

We assessed IDEA's enterprise profile as very strong, characterized by healthy demand with a solid waitlist, excellent academics, and an experienced and sophisticated management team. Senior management has engaged in long-term comprehensive planning, with a demonstrated track record of successful execution and an ability to consistently secure significant fundraising as part of a systematic expansion plan, coupled with a great relationship with TEA in Midland Independent School District as an expansion partner. We assessed IDEA's financial profile as adequate, reflecting a history of positive and improving operations supported by significant fundraising, offset by a high debt burden, and limited liquidity position for the rating coupled with significant expansion plans. While IDEA's financial metrics are modest for the rating, in our opinion this is offset by IDEA's enterprise profile strengths and demonstrated ability to expand while maintaining healthy margins and broadening its brand without diminishing demand. We believe that, combined, these credit factors lead to an indicative stand-alone credit profile of 'a-' and a final rating of 'A-'.

The 'A-' underlying rating reflects our view of IDEA's:

- Superior enterprise profile reflected in the entity's reputation as one of the largest charter school systems in the country based on enrollment, with robust double-digit annual enrollment growth in the past 10 years, high academic performance, and steady demand;
- Sophisticated management team overseeing an extensive bench and succession planning that should ensure continuity of the organization's ability to execute its mission;
- Historically positive operating margins, generating satisfactory coverage levels for the rating despite an aggressive growth campaign that we expect will continue to improve; and
- Consistently favorable test scores that remain well above the state average, despite more than 90% of enrolled students being considered at risk or economically disadvantaged.

Partially offsetting the above strengths, in our opinion, are:

- The school's moderately high debt burden with significant capital plans that will require additional debt, and are tied to ongoing expansion efforts, although we expect IDEA to supplement borrowing with substantial government grants and private philanthropy in advance of its planned expansions, reducing future debt requirements;
- Only satisfactory liquidity for the rating level with 133 days' cash on hand at fiscal year-end 2019 and similar to improved levels expected for fiscal 2020;and

- Risk, as with all charter schools, that the charter can be revoked because of nonperformance of the school's charter or for financial distress before the bonds' final maturity; in our opinion, this is offset by the strength of IDEA's proven academic track record and support from TEA.

The series 2019 bonds (\$213 million par amount) are fixed-rate obligations on parity with IDEA's existing debt and secured by IDEA's revenue, as defined in the governing bond documents consisting primarily of per-pupil funding from the state. Bond proceeds will fund development of multiple campuses in the Rio Grande Valley, San Antonio, Austin, El Paso, Tarrant County, and Houston regions, which includes the repayment of about a \$39.4 million capital line of credit, allowing officials the ability to open approximately 20 new Texas schools for fall 2020.

The 'AAA' long-term program rating on the series 2019 bonds reflects our view of IDEA's participation in the Texas Permanent School Fund (PSF) Bond Guarantee Program, which provides the security of a permanent fund of assets that could be used to meet debt service on the series 2019 bonds. The PSF additionally secures IDEA's 2014, 2015, 2016A, 2017, and 2018 obligations under separate agreements. For more information on the long-term program rating, please see our report "Texas Permanent School Fund State Revolving Funds/Pools," published June 7, 2019, on RatingsDirect. Following this issuance, the Texas PSF will guarantee approximately \$834 million of IDEA's pro forma debt.

IDEA is a Texas nonprofit incorporated in 2000. The corporation operates and does business as Individuals Dedicated to Excellence and Achievement Public Schools. IDEA is a state-authorized, open-enrollment charter school. While it originated in the Rio Grande Valley as a single-site charter school, IDEA began in fall 2019 with 91 schools and an enrollment of more than 51,000 students. For the 13th straight year, officials report 100% college acceptance for IDEA's graduating class, which we view a favorable market demand factor and supportive of the school's reputation as a high performing academic institution and supporting IDEA's ability to raise more than \$423 million toward its expansion costs.

In 2016, IDEA formed IPS Enterprises LLC to serve as the legal vehicle for its management services for non-charter activities inside and outside Texas. This includes management agreements with other potential charters outside the state, such as IDEA Public Schools Louisiana Inc. (IDEAL), which is a completely separate and distinct entity from IDEA. Each operates as a separate legal entity and neither is responsible for the other's obligations, unless clearly stated in a previous contractual agreement. IDEA assets will not be used to support IDEAL, which opened four schools on two campuses in fall 2018. At this time, our group rating methodology does not apply due to the separation of management and distinctly separate financial obligations; however, should the schools develop additional support mechanisms we could apply the additional criteria.

Outlook

The stable outlook on the 'AAA' rating reflects our view of the strength of the Texas PSF guarantee, based on the fund's assets and performance.

The stable outlook on the 'A-' rating reflects our expectation that, despite significant expansion plans, during the next two years, IDEA will maintain a steady financial profile by continuing to generate positive margins above 5%, sustain

maximum annual debt service (MADS) at current levels, and maintain or improve its cash position. We expect IDEA to adhere to its strategic financial practices that include grouping operational targets based on previous fiscal-year results, conservative modeling, and flexibility to moderate expansion plans if financial targets could not be met. We also anticipate the school's demand profile will continue to reflect very strong academics and increasing enrollment.

Downside scenario

We could lower the rating if IDEA is unable to maintain or continue to improve current financial results. We could also lower the rating if enrollment trends differ from our expectations.

Upside scenario

A positive rating action is unlikely to occur over the two-year outlook period given the current high rating level, and IDEA's modest financial metrics for the rating.

Enterprise Profile

Economic fundamentals

IDEA, with 91 schools as of fall 2019, primarily serves Hidalgo County along the Rio Grande Valley. IDEA also serves Cameron and Starr counties in the Rio Grande Valley. Hidalgo County's minor population is healthy at about 374,000 and is expected to exhibit solid growth, with projections of a 5% increase through 2024. IDEA also serves Travis County in the Austin area, Bexar County encompassing San Antonio, El Paso and, most recently, Tarrant County. IDEA's service area has substantial minor populations slated to increase at favorable rates through 2024.

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 IDEA's enrollment and demand profile as healthy supported by rapidly growing enrollment averaging of over 20% annually for the past five years and in conjunction with a robust, although softening waitlist on a percentage base but higher on a nominal basis, increasing by 1,600 for fall 2019. For fall 2018, officials reported nearly 40,492 students enrolled for the start of the school year and have begun fall 2019 with more than 51,000, or about 4,000 more students than budgeted. IDEA's waitlist, which management purges annually, was more than 38,222, or 94% of enrollment for fall 2018. We expect the school to maintain waitlists in line with historical averages in the future. IDEA's solid academic programs allow it to maintain a very strong market share across Texas. The school outperformed local school districts and the state in many components of Texas' standardized test scores, and we view its 100% graduation rate as superior. According to officials, 68% of students who entered IDEA after failing a state exam at their previous school completed their first year at IDEA having passed at least one state exam. We anticipate IDEA maintaining its very strong demand profile over the outlook horizon, as performance on state exams and national awards strengthens the brand.

IDEA's standing with authorizer TEA is very good, in our view, as demonstrated by 10 campuses receiving all seven academic distinctions from the state and the majority of the remaining campuses receiving multiple distinctions. IDEA has held its charter with TEA for more than 19 consecutive years and has renewed it twice, most recently in February 2015 and it extends through July 2025. We view this renewal as a sign of TEA's faith in the organization. Along with the charter renewals, TEA approved an increase in the school's enrollment cap to 30,000 in 2013, 45,000 in 2014, and 60,000 in 2015, where it currently stands. We believe IDEA's consecutive state-approved enrollment cap increasingly demonstrates strong support from the school's authorizer. TEA is also the administrator of the Texas PSF Program. Following this issuance, the Texas PSF will guarantee approximately \$834 million of IDEA's pro forma debt or 46% of the total guaranteed charter school Texas PSF debt outstanding. We believe, this relationship with TEA, along with the TEA recently asking IDEA to partner with Midland Independent School District to improve an underperforming school, reflect a strong relationship between IDEA and its charter authorizer.

The statutory framework assessment reflects our opinion that, while there might be some areas of risk, the framework is not likely to negatively affect IDEA's future ability to pay debt service.

Following the passing of House Bill (HB) 3 from the most recent session of the Texas state legislature, charter schools received additional funding for new instructional facilities through and expanded New Instructional Facilities Allotment (NIFA). Although HB 3 did increase state funding for both traditional public schools and charter schools, all Texas public schools will experience an increase in Texas Retirement System contributions. Management estimates that IDEA will receive an increase of \$684 per student for fiscal 2020 because of HB3. Officials have historically budgeted conservatively relative to state aid, which should remain favorable over our two-year outlook horizon.

Management and governance

IDEA is governed by a 15-member system board, whose members serve staggered three-year terms, with vacancies filled by vote of the remaining directors. The board organizes standing committees, including an executive committee and a budget/finance committee. There are also advisory boards (regional boards) for the campuses that include local community members. The chair of each regional board sits on the system board. Management is experienced and capable, in our opinion: Top executives/founders have actively participated in education policy at the national level, attracting more than \$423 million of private philanthropy and government grant awards to IDEA in just the past five years (2015-2019). This figure includes nearly \$117 million in funding through the U.S. Department of Education's Replication and Expansion Grant. Officials were able to secure more than \$50 million in funding to finance expansion into the Permian Basin through 2026. Management reports that the school will continue to aggressively seek out grants and philanthropic support as a key part of the network's strategic expansion plan. IDEA was awarded the Broad Prize for Public Charter Schools, which honors the public charter management organization (CMO) that demonstrates the most outstanding overall student performance and improvement among the country's largest CMOs, while reducing achievement gaps for economically disadvantaged and minority students. IDEA received \$250,000 cash as part of the award. Furthermore, the co-founders are actively engaged in overseeing daily operations and were recently inducted in the 2018 National Charter School Hall of Fame. We believe that IDEA's longevity and success, coupled with succession plans that are in place, mitigate founder risk.

IDEA's senior management team and board of directors have been stable, and some members have been in place since the school's founding. Management has not made changes to senior leadership, with the exception of hiring executive

directors for new regions like El Paso. The board remains very supportive of management and its ability to handle day-to-day operations.

In our view, management continues to be active in assessing the school's long-term goals and applying solutions to meet them. It has set a high academic standard that continues to strengthen IDEA's demand profile. Financial operations are managed acceptably, in our opinion, and we view management as superior and anticipate the team to remain stable.

Financial Profile

Financial performance

While IDEA's financial metrics are modest for the rating level, the school's financial performance can be characterized by consistently positive operating margins with satisfactory lease-adjusted MADS coverage, supported by rapid enrollment growth, a healthy state funding environment, and management's ability to keep expense growth modest based on its routine systematic multi-year operational- and capital-budget forecasting. Based on fiscal 2019 results, the school produced an EBIDA margin of 18%, or approximately \$94.3 million, translating into 1.62x pro forma MADS coverage. The combination of IDEA's enrollment growth, coupled with healthy state funding and the organization's ability to seek and obtain materially significant grant funding, is allowing officials additional operational and capital flexibility. This is evident in higher pro forma MADS coverage than previous years and more capital funding available to open campuses in addition to those the state provides. IDEA has historically produced favorable excess revenue margins averaging over 8% annually in the past five years. Based on audited fiscal 2019 results, IDEA ended the year with a 7.8% excess margin. Management is conservatively projecting to end fiscal 2020 with a full-accrual surplus of about \$110 million based on beginning the fiscal year with about 4,000 more students than originally budgeted and thereby maintain its acceptable MADS coverage (for the rating). We expect the organization's operating base will continue to grow significantly over the outlook horizon as IDEA systematically and thoughtfully expands the brand across Texas. The school has typically performed better than budgeted and we believe results will be better than historical results beyond 2020 based on higher per pupil funding approved in the most recent legislative session and higher-than-budgeted enrollment. Consequently, we expect IDEA to continue to generate excess revenue margins materially above 5% annually if not improve based on the current funding environment.

Liquidity and financial flexibility

We consider the school's balance sheet satisfactory for the 'A'-rating level. Based on fiscal 2019 results, IDEA had about 133 days' cash on hand, and management expects to end fiscal 2020 with slightly higher cash levels. We expect IDEA's positive operating performance to continue and to assist the school in maintaining a satisfactory or better liquidity position for the rating level.

IDEA's unrestricted reserves as a percent of debt based on audited fiscal 2019 figures were 19%, which we view as sufficient. The school has increased its unrestricted net assets (UNA) position in recent years. The UNA position continues to increase as the school expands and enrollment increases. Unrestricted reserves have increased by more than five times--based on audited fiscal 2019 figures--to \$164 million from \$30.2 million in fiscal 2013. We anticipate the growth to continue in fiscal 2020.

The school continues to attract substantial grant and gift receipts. From 2015 through 2019, IDEA has pledged or committed funds of more than \$423 million. In 2019, the school received a federal grant for more than \$116 million over five years to aid in relocation and expansion. It has also received a pledge of about \$50 million over five years to operate in the Permian Basin. We believe IDEA's success in this area should continue, as the organization has a dedicated advancement division that works in conjunction with other key divisions to ensure funds are raised to coincide with IDEA's strategic and systematic expansion plans. Officials report that the goal for 2020 is \$70 million, up from \$55 million in 2019. IDEA shattered the 2019 goal by more than \$130 million (aided by the two major grants and gifts mentioned above) but officials are optimistic that they will hit their \$70 million target. IDEA has yet to not meet a formal fund raising goal. We view this ability as a major credit factor given its size and impact on the school's enterprise and financial profile through allowing for extensive teacher and leadership training, coupled with operating costs for new campuses. We view the level of grant and gift support IDEA receives as favorable compared with that of peers and a positive credit factor supporting the rating.

Debt burden

Following the series 2019 issue, IDEA will have about \$1 billion of debt, with annual lease-adjusted debt service of approximately \$50 million-\$60 million and MADS of \$61.3 million in fiscal 2022. This translates into a high pro forma debt burden of about 12% of audited fiscal 2019 revenues. IDEA has no additional contingent liabilities or off-balance-sheet debt. While we view the school's pro forma debt burden as high on a per student basis at more than \$25,000, we understand IDEA has no plans to take on additional debt unless current enrollment can support the subsequent year bond issue. However, based on current fall 2019 enrollment numbers, pro forma debt per student is closer to \$19,800. We would view the ability to reduce pro forma debt per student from the previous level, in the face of expansion plans, as a favorable improvement for the organization's debt profile despite a highly leveraged balance sheet.

Officials have firm plans to issue about \$350 million in fiscal 2021 as part of IDEA's five-year capital plan. Officials plan to open new schools in Texas as follows:

- In fiscal 2020, 16;
- In fiscal 2021, 20;
- in fiscal 2022, 30; and
- In fiscal 2023, 32.

While IDEA's expansion plan is consistently in line with projections risks associated with expansion somewhat mitigated by management's policy to delay specific elements of the plan until sufficient fundraising is in place to cover operations for two years, or if proceeding with debt financing would cause internal MADS pro forma calculations below 1.35x inclusive of grants and gifts.

As part of IDEA's rigorous financial planning, before entering a new market, IDEA performs a market analysis to ascertain the likelihood of the new area absorbing up to 10 IDEA campuses, the ability to govern the school to the established standard, the quality of the authorizer structure in place, the regulatory environment, the talent pool of future staff and administrators, availability of facilities, and local community support among community leaders and

residents at large. We view IDEA's approach to expansion as a credit strength and a reflection of the school's strong management, as we believe it significantly reduces speculative elements of expanding the enterprise. We expect IDEA to issue additional debt in accordance with its expansion model, which should allow for growth at a pace that does not soften financial operating metrics. Given continued expansion plans, we expect IDEA to remain highly leveraged over the outlook horizon.

As with many charters, the organization's debt-to-capitalization ratio shows significant leverage on its balance sheet. Based on fiscal 2019 figures, IDEA's pro forma ratio was 100%, which we view as elevated. As per our criteria, this ratio only uses UNA and does not include about \$149.8 million of temporarily restricted assets attributed to state aid that will be available for construction and operations. The organization's debt burden is a constraining factor at the 'A-' rating level, and we expect these ratios will remain high over the outlook horizon.

Financial policies

IDEA 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 negatively affect its 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

Idea Public Schools, Texas						
Enterprise And Financial Statistics						
	--Fiscal year ended June 30--					Medians for 'BBB+' rated charter schools
	2019	2018	2017	2016	2015	2018
Enrollment						
Total headcount (no.)	40,492	33,747	28,461	23,313	18,528	2,354
Total waitlist (no.)	38,222	28,577	26,477	34,525	26,325	MNR
Waiting list as % of enrollment	94.4	84.7	93.0	148.1	142.1	51.3
Financial performance						
Total revenues (\$000s)	518,237	417,737	332,775	269,169	213,068	25,383
Total expenses (\$000s)	477,675	379,347	305,765	248,709	194,650	MNR
EBIDA (\$000s)	94,292	79,240	59,420	47,884	39,403	MNR
EBIDA margin (%)	18.2	19.0	17.9	17.8	18.5	15.8
Excess revenues over expenses (\$000s)	40,562	38,390	27,010	20,460	18,418	MNR
Excess income margin (%)	7.8	9.2	8.1	7.6	8.6	6.3
Operating lease expense	5,232	657	2,818	2,249	2,150	MNR
Lease-adjusted annual debt service coverage (x)	2.28	2.65	2.13	1.63	1.29	MNR
Lease-adjusted annual debt service burden (% total revenues)	6.0	7.2	8.8	11.4	15.1	MNR
MADS (\$000s)	N.A.	40,196	33,766	32,831	24,801	2,153
Lease-adjusted MADS coverage (x)	N.A.	1.99	1.84	1.53	1.68	1.90
Lease-adjusted MADS burden (% total revenues)	N.A.	9.6	10.1	12.2	11.6	8.4

Idea Public Schools, Texas (cont.)

Enterprise And Financial Statistics

	--Fiscal year ended June 30--					Medians for 'BBB+' rated charter schools
	2019	2018	2017	2016	2015	2018
Pro forma MADS (\$000s)	61,264	50,225	0	N.A.	29,614	MNR
Pro forma lease-adjusted MADS coverage (x)	1.62	1.59	N.A.	N.A.	1.40	MNR
Pro forma lease-adjusted MADS burden (% total revenues)	11.8	12.0	0.0	N.A.	13.9	MNR
Total revenue per student (\$)	12,798.5	12,378.5	11,692.3	11,545.9	11,499.8	MNR
Balance-sheet metrics						
Days' cash on hand	133.13	126.89	126.35	124.36	118.50	181.80
Total long-term debt (\$000s)	799,423	613,048	469,907	387,067	315,923	MNR
Unrestricted reserves to debt (%)	20.0	19.2	20.0	20.4	18.4	42.6
Unrestricted net assets as % of expenses	(0.1)	0.7	0.5	0.2	0.4	60.0
Debt to capitalization (%)	100.0	99.6	99.7	99.9	99.8	67
Debt per student (\$)	19,181	18,197	16,743	16,351	17,205	11,482
Pro forma metrics						
Pro forma unrestricted reserves (\$000s)	164,026	N.A.	N.A.	N.A.	N.A.	MNR
Pro forma days' cash on hand	133	N.A.	N.A.	N.A.	N.A.	MNR
Pro forma long-term debt (\$000s)	1,012,658	N.A.	N.A.	N.A.	N.A.	MNR
Pro forma unrestricted reserves to debt (%)	16.2	N.A.	N.A.	N.A.	N.A.	MNR
Pro forma debt to capitalization (%)	100	N.A.	N.A.	N.A.	N.A.	MNR
Pro forma debt per student (\$)	25,009	N.A.	N.A.	N.A.	N.A.	MNR

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 October 2, 2019)

Pharr Hgr Ed Fin Auth, Texas

Idea Public Schools, Texas

Series 2009A

Long Term Rating

A-/Stable

Upgraded

San Juan Hgr Ed Fin Auth, Texas

Idea Public Schools, Texas

Series 2010 A, B & Q

Long Term Rating

A-/Stable

Upgraded

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