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## Newark Higher Education Finance Corp., Texas Orenda Education; Charter Schools

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# Newark Higher Education Finance Corp., Texas Orenda Education; Charter Schools

Credit Profile		
<b>Arlington Hgr Ed Fin Corp, Texas</b>		
Orenda Ed, Texas		
<b>Series 2013 A&amp;B</b>		
<i>Long Term Rating</i>	BBB/Stable	Upgraded
<b>Newark Higher Ed Fin Corp, Texas</b>		
Orenda Ed, Texas		
Newark Higher Ed Fin Corp (Orenda Ed) Ed Rev and Rfdg Bnds (Orenda Ed) ser 2015A due 08/15/2044		
<i>Long Term Rating</i>	AAA/Stable	Current
<i>Underlying Rating for Credit Program</i>	BBB/Stable	Upgraded
Newark Higher Ed Fin Corp (Orenda Ed) Ed Rev and Rfdg Bnds (Orenda Ed) ser 2015B due 08/15/2020		
<i>Long Term Rating</i>	AAA/Stable	Current
<i>Underlying Rating for Credit Program</i>	BBB/Stable	Upgraded
<b>Texas Pub Fin Auth Charter Sch Fin Corp, Texas</b>		
Orenda Ed, Texas		
<b>ser 2011A, B, Q</b>		
<i>Long Term Rating</i>	BBB/Stable	Upgraded

## Rationale

S&P Global Ratings raised its underlying rating on Newark Higher Education Finance Corp., Texas' education revenue refunding bonds, issued for Orenda Education, to 'BBB' from 'BBB-'. At the same time, S&P Global Ratings raised its long-term ratings on Arlington Higher Education Finance Corp. and Texas Public Finance Authority Charter School Finance Corp. to 'BBB' from 'BBB-'. The series 2011 and 2013 bonds are not part of the Texas Public School Fund Guarantee (PSF) program. The outlook is stable.

The upgrade reflects our view of the school's improved financial metrics in recent years coupled with continued expected and projected healthy margins for fiscal 2016 and fiscal 2017, respectively. While we understand Orenda has additional debt plans over the next two-to-three years, in our view, the school's ample unrestricted reserves and healthy operations should provide sufficient cushion to absorb the additional debt at the current rating level. However, we expect to evaluate the impact of any additional debt at the time of issuance. The rating continues to reflect our opinion of Orenda's consistently good coverage and strong days' cash on hand, which we expect the school to sustain.

The rating further reflects our view of Orenda's:

- Very strong unrestricted cash reserves, as measured by 228 days' cash on hand at the end of fiscal 2015; although we understand management may draw down a modest portion of cash to help fund future capital projects, officials

plan to maintain roughly 200 days' cash on hand;

- Long operating history, with a recent successful charter renewal for a 10-year term through 2025;
- Robust coverage ratios for the sector, with lease-adjusted maximum annual debt service (MADS; \$1.8 million) coverage of 1.8x for fiscal 2015;
- Consistent enrollment growth, as evidenced by an increase in students to 1,582 in fall 2016 from 185 in fall 2009; and
- Sound management team that is focused on building headcount and the financial profile.

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

- Plans to issue additional debt in 2018 to complete Phase III of the school's capital plan to serve students who are currently in modular facilities;
- Potential competition from the Georgetown Independent School District (ISD) and Roundrock ISD, with Georgetown ISD recently replacing older facilities. Relatively high leverage, with a MADS burden (MADS compared to operating expenses) of 15% in fiscal 2015; and
- The inherent uncertainty associated with charter renewals because the final maturity of the bonds exceeds the time horizon of the existing charter.

The school has \$25.7 million total debt outstanding consisting of \$25.6 million of bonds and \$69,000 of a capital lease. The bonds, which comprise series 2011A, 2011B, 2011Q, 2015A, and 2015B, are general obligations of the school and are secured by available revenues. Debt service is flat, with current MADS on the bonds at \$1.2 million in fiscal 2019. We understand Orenda plans to issue roughly \$13 million of additional debt, although at this time plans are still somewhat preliminary and projections, incorporating this debt, were not available. Therefore, while our analysis incorporates these plans, the financial ratios cited do not reflect the impact of this additional debt.

According to bond documents provided to S&P Global Ratings, bond holders are provided with operating and liquidity covenants. The liquidity covenant requires maintenance of 45 days' cash on hand, and the operating covenants require annual debt service coverage of 1.1x. If debt service falls below 1.1x but remains above 1.0x management may be required to engage a consultant acceptable to the issuer. If annual debt service coverage falls below 1.0x an event of default may be declared. Before the issuance of other long-term debt, an additional bonds test requires 1.1x pro forma MADS coverage on a historical basis and 1.2x forward MADS coverage on existing and proposed debt.

## Outlook

The stable outlook on the underlying rating reflects our expectation that over the two-year outlook period Orenda will maintain its strong financial performance and liquidity position, in addition to continuing to meet its projected enrollment targets as the school continues to execute its expansion plans. We plan to evaluate the impact of additional debt or program expansion at the time of implementation.

### Downside scenario

We could consider a negative rating action should any enrollment or funding pressures constrain operations, leading to sustained MADS coverage or liquidity significantly below current levels. In addition, should the school's debt issuance result in a material weakening in financial metrics to levels no longer consistent with the 'BBB' rating level, this could result in a negative rating action.

## Upside scenario

We do not expect a positive rating action over our outlook horizon given our view of the school's relatively high leverage and future debt plans.

## Enterprise Profile

### Enrollment

Orenda, located about 30 miles north of Austin, is an open-enrollment charter school founded in 2001 in Georgetown, Texas. The school currently operates out of five campuses throughout the state: two in Georgetown (GCPS, offering kindergarten through grade 12 [K-12], and Gateway Tech High School, offering grades nine through 12), one in Kingsland (offering K-8), one in Belton (offering K-5), and one in Goldthwaite (offering K-12). As of fall 2016, total enrollment from all five campuses reached 1,522 students compared with 1,377 students in fall 2015. This fall 2016 headcount represents nearly an 86% increase since fall 2011, when management operated with 819 total students. Enrollment levels were relatively flat from fiscal years 2015 to 2016 as the school consolidated facilities; positive enrollment trends are evident following the completion of new updated facilities.

Of the more than 1,500 students, 1,300 attend Orenda's newest campus, GCPS, in fall 2016. Phase I of Orenda's expansion plan for GCPS, which was funded from the 2011 bond proceeds, is complete, and the current facility is already near capacity. Phase II of Orenda's capital plan is also complete, and GCPS is now able to accommodate the designed maximum enrollment of 1,300. The contemplated Phase III could replace a modular building with permanent classroom space keeping enrollment capacity at current levels. Orenda's other Georgetown campus, Gateway Tech, operates at near capacity.

The Kingsland and Belton campuses are about 60 and 30 miles west and north, respectively, of Austin. A facility in Goldthwaite is a privately owned residential treatment/care facility for young individuals who have been referred to the residential facility by Child Protective Services.

The wait list for fall 2015 was 146 students, down from 152 students in fall 2014. School officials also report that retention rates are difficult to estimate given the fluctuations in the number of students attending the hybrid campuses, but management estimates the rate to be about 87% for the 2015-2016 school year.

Competition for Orenda's Gateway Tech and GCPS comes primarily from Georgetown and Roundrock ISDs. Georgetown has recently renovated several of its facilities and there are plans for a new high school in Roundrock. School officials do not envision that local competition will have a profound effect on operations, and they believe the local school districts remain well-positioned in their respective markets given area growth projections following highway improvements.

### Curriculum and academic performance

The school's curriculum focuses on core academic subject areas and state standards, while offering an abundance of extracurricular activities for a charter school. Although Orenda's academic performance has been somewhat volatile in the past, we view it as adequate and improving. According to the most recent 2015 State of Texas Assessments of Academic Readiness (STAAR) ratings, GCPS placed in the top 12% of all Texas public schools, "met standards," and

earned distinctions in five of seven categories. We believe this achievement will allow Orenda to sustain its positive demand profile.

The Gateway Tech campus, which is not eligible to receive distinctions, met standards as well. As per a previous legislative action, Orenda's residential facility or hybrid campuses are exempt from such assessments hereafter, and the STAAR ratings will be based only on the Gateway campuses.

### **Management and governance**

The senior leadership is well-seasoned and long-serving. Orenda's founder and CEO, Richard Rickey, was a former hospital executive and incorporated Orenda in 1995 as a private not-for-profit shelter for abused or neglected children; he has been with the district since its inception in 1999. Orenda's business manager has been with the district since 2009, having previously worked for an ISD. The school has a stable board of directors that consists of four members from the community out of total five board members. The board is actively involved in the governance of the school and works closely with the school's management team and authorizer.

## **Financial Profile**

### **State funding environment**

In Texas, the state rather than local sources provides the majority of public school operating dollars. Therefore, charter schools depend almost entirely on the state for operating revenue that is subject to annual appropriation by the legislature. As a result, Texas' economic and financial situation has a direct impact on a school's operations, and funding will fluctuate along with the state economy. Recently, the Texas Legislature overwhelmingly approved legislation to increase the number of open-enrollment charter schools to 305 by 2019 from the current 215, and to give the Texas Education Agency more flexibility to fast-track charter renewals for successful schools, as well as enhanced authority to revoke charters for schools after three years of unsatisfactory performance instead of four. The legislation included a partial restoration of some cuts from the previous legislative session (2011). For the entire education system, public schools included, \$3.4 billion (63%) of the \$5.4 billion cut at the previous legislation session was restored, and the expected impact on charters is an estimated additional \$200 per weighted-average daily attendance. As with the initial cuts in 2011, the partial restoration came during the 2013-2014 school year and increased for the 2014-2015 school year. We expect that funding in Texas will remain at least flat in the future.

### **Operations**

Operations have been positive for at least the past five years, in part due to increases in enrollment as GCPS filled in grades. Orenda ended fiscal 2015 with an operational surplus of \$1.1 million or an excess margin of 8.2%, compared with fiscal 2014's \$833,000 surplus. On an EBIDA basis, the school finished fiscal 2015 with a \$2.8 million surplus, supporting good, in our view, lease-adjusted MADS coverage at 1.8x.

Based on unaudited fiscal 2016 results, the school anticipates ending this year with a sizable surplus of approximately \$1.3 million and has budgeted for similar results for fiscal 2017. Officials attribute the school's recent and projected good financial performance to positive enrollment trends and tight expenditure controls as the school continues to function within a mature capital and operational phase where maximizing efficiencies rather than expansion is management's main focus. As a result, we expect lease adjusted MADS coverage to remain close to 1.8x in the near

term.

## Balance sheet

The school's financial position has been positive and remains strong. Orenda increased its ending unrestricted net assets about 10% to \$3.6 million in fiscal 2015. As of Aug. 31, 2015, Orenda held about \$5.7 million in unrestricted cash and investments, or about 228 days' cash on hand, which we consider strong for a charter school. The significant growth in cash is due to strong operating results. We understand management may use some cash to help fund future capital projects, as there are plans to add a new campus; however, we anticipate levels will remain strong for the rating since management plans to maintain roughly 200 days' cash on hand. Given the school's historical and projected good operating margins, Orenda's liquidity is projected to grow and provide the school with the capacity to potentially use a portion to supplement future projects and easily maintain net cash levels at around 200 days.

Orenda Education, Texas						
	--Fiscal year ended Aug. 31--					
	2017	2016	2015	2014	2013	Medians for 'BBB' rated charter schools
<b>Enrollment</b>						
Total headcount	1,522	1,377	1,326	1,206	999	2,371
Total waiting list	128	146	152	381	247	MNR
Waiting list as % of enrollment	8.4	10.6	11.5	31.6	24.7	90.2
<b>Financial performance</b>						
Total revenues (\$000s)	N.A.	N.A.	12,932	11,413	10,323	MNR
Total expenses (\$000s)	N.A.	N.A.	11,871	10,580	8,646	MNR
EBIDA (\$000s)	N.A.	N.A.	2,807	1,974	2,447	MNR
EBIDA margin (%)	N.A.	N.A.	21.71	17.30	23.70	17.10
Excess revenues over expenses (\$000s)	N.A.	N.A.	1,061	833	1,677	MNR
Excess income margin (%)	N.A.	N.A.	8.20	7.30	16.25	6.4
Lease-adjusted annual debt service coverage (x)	N.A.	N.A.	1.85	1.69	1.84	1.9
Lease-adjusted annual debt service burden (% total revenues)	N.A.	N.A.	14.1	14.0	14.2	MNR
Lease-adjusted annual debt service burden (% total expenses)	N.A.	N.A.	15.4	15.1	16.9	MNR
MADS (\$000s)	N.A.	N.A.	1,819	2,150	2,150	2,142
Lease-adjusted MADS coverage (x)	N.A.	N.A.	1.86	1.26	1.25	1.8
Lease-adjusted MADS burden (% total revenues)	N.A.	N.A.	14.1	18.8	20.8	MNR
Lease-adjusted MADS burden (% total expenses)	N.A.	N.A.	15.3	20.3	24.9	10.90
Pro forma MADS (\$000s)	N.A.	N.A.	N.A.	1,753	0	MNR
Pro forma lease-adjusted MADS coverage (x)	N.A.	N.A.	N.A.	1.54	0.0	MNR
Pro forma lease-adjusted MADS burden (% total revenues)	N.A.	N.A.	N.A.	15.4	0.0	MNR
Pro forma lease-adjusted MADS burden (% total expenses)	N.A.	N.A.	N.A.	16.6	0.0	MNR
Total revenue per student (\$)	N.A.	N.A.	9,753	9,464	10,333	MNR

## Orenda Education, Texas (cont.)

	--Fiscal year ended Aug. 31--					Medians for 'BBB' rated charter schools
	2017	2016	2015	2014	2013	
<b>Balance sheet metrics</b>						
Days' cash on hand	N.A.	N.A.	228.4	275.6	178.3	157.00
Total long-term debt (\$000s)	N.A.	N.A.	25,692	21,103	10,471	MNR
Unrestricted reserves to debt (%)	N.A.	N.A.	26.7	36.3	39.2	32.1
Unrestricted net assets as % of expenses	N.A.	N.A.	32.6	31.9	30.0	38.6
General fund balance (\$000s)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Debt to capitalization (%)	N.A.	N.A.	87.7	86.4	80.6	MNR
Debt per student (\$)	N.A.	N.A.	19,109	17,137	10,481	11,451
<b>Pro forma metrics</b>						
Pro forma unrestricted reserves (\$000s)	N.A.	N.A.	N.A.	N.A.	1,505	MNR
Pro forma days' cash on hand	N.A.	N.A.	N.A.	N.A.	65.42	MNR
Pro forma long-term debt (\$000s)	N.A.	N.A.	25,692	21,103	10,471	MNR
Pro forma unrestricted reserves to debt (%)	N.A.	N.A.	N.A.	N.A.	14.4	MNR
Pro forma debt to capitalization (%)	N.A.	N.A.	88.88	88.26	80.61	MNR
Pro forma debt per student (\$)	N.A.	N.A.	19,376	17,498	10,481	MNR

N.A.--Not available. N/A--Not applicable. MNR--Median not reported. MADS--Maximum annual debt service.

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