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Caliber Schools, California; Charter Schools

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ICR

Long Term Rating

BB+/Stable

New

Rationale

S&P Global Ratings assigned its 'BB+' issuer credit rating (ICR) to Caliber East Bay Real Estate (CEBRE), Calif., representing Caliber Schools (Caliber), which currently operates two charter schools in Vallejo and Richmond. 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; bankruptcy standing; or liquidation, statutory preference, or legality and enforceability. CEBRE is a California not-for-profit corporation formed to support Caliber Public School's real estate facilities.

Based on our group rating methodology criteria, published July 1, 2019, our rating analysis encompasses the entire Caliber organization, given the network approach to general strategy and shared oversight over all campuses by a common board. The rating reflects our group credit profile on Caliber and our view that the ChangeMakers Academy campus is obligated to support the loan is core to the organization. The obligated group accounts for a substantial portion, of the revenue and enrollment of Caliber Public Schools. Given the obligated group's core status, the ratings are equal to that of the group credit profile. The loan from the Equitable Facilities Fund (EFF) formerly known as Charter Impact Fund will be secured by a pledge of revenue from Change Makers and that school's campus only. Financial metrics cited in this report reflect those of the entire Caliber organization unless otherwise specified.

We assess Caliber's enterprise profile as adequate, characterized by its healthy and rapidly growing enrollment base, sufficient waitlist, good academics compared to the district and state; and capable and experienced management team. We assessed Caliber's financial profile as vulnerable, characterized by sufficient pro forma lease-adjusted maximum annual debt service (MADS) coverage and decent liquidity levels, although operating margins are expected to moderate in fiscal 2020. We view the school's reliance on fundraising as an operational risk given the unpredictability of gift giving. Although we recognize that Caliber has maintained consistent donor support based on diversification of sources, and is working toward building a longer track record. We expect the school to continue to receive material support from grants and fundraising. Combined, these credit factors led to an indicative stand-alone credit profile of 'bb'. As our criteria indicate, the final rating can be adjusted above or below the indicative credit level due to a variety of overriding factors. In our opinion, the 'BB+' final ICR better reflects Caliber given the school's solid demand and enrollment, capable management team, good coverage, and manageable debt burden.

More specifically, the rating reflects our opinion of Caliber Schools':

- Short operating history, with one school in its sixth year of operations and another in its fourth year, and limited track record;
- Expected tightening of operating margins and MADS coverage in fiscal 2020 and reliance on fundraising;
- Risk, as with all charter schools, that the charter authorizer could close the school for nonperformance of its charter or financial distress prior to the bonds' final maturity.

Partly offsetting the above weaknesses, in our view, are Caliber Schools':

- Healthy demand and enrollment growth supported by a sufficient wait list;
- Good academic performance that outperforms local district competitors;
- Experienced and capable management team, overseen by an active and engaged board of directors; and
- Good relationship with its two authorizers.

Caliber schools is a two school network established in 2014. The first campus, Beta Academy opened in 2014 and has quickly expanded to 862 students as of the 2019-2020 academic year in transition kindergarten through 8th grade (K-8). Beta Academy is located in Richmond. With the passage of Proposition 51, the school was recently approved under the California Charter School Facility Program for a \$26 million remodeling and construction project. Under this program, Caliber will be awarded a 50% grant and access to a 50% loan for the improvement project with a 30-year term and approximately a 2.25% interest rate. The new campus is approximately 6 miles from the existing school and has capacity for 900 students. The projected is expected to be completed in fall 2021. ChangeMakers Academy is Caliber's second campus located in Vallejo and opened in 2016 with 306 students. The school has also quickly expanded to 754 students as of the 2019-2020 academic year and serves grades K-8. Caliber will receive a \$14.5 million loan from EFF to exercise the purchase option of the ChangeMakers facility and reimburse costs of minor improvements to the facility.

Total pro forma debt, including the EFF loan and the Proposition 51 loan, is approximately \$27.3 million. The EFF loan is secured by revenue of the ChangeMakers Academy paid through a state intercept mechanism, in addition to a first lien mortgage on the real estate of ChangeMakers Academy.

Outlook

The stable outlook reflects our expectation that during the next year management will continue to grow enrollment while meeting budgeted expectations, and maintain steady MADS coverage and liquidity levels. Additionally, we expect the school to meet its fundraising goals and remain in compliance with financial covenants.

Downside scenario

We could take a negative rating action if the school fails to meet enrollment projections, operations weaken greater than expected, MADS coverage declines, or unrestricted reserves are depleted.

Upside scenario

We do not expect to take a positive rating action during the one-year outlook period, however we could take a positive rating action over the longer-term, if the school can demonstrate a longer track record of operational stability, improve lease-adjusted MADS coverage and grow liquidity to levels commensurate with a higher rating. Additionally, we would expect ChangeMakers Academy to successfully renew its charter for a full term in 2021.

Enterprise Profile

Economic Fundamentals

Caliber's Beta Academy is located in Contra Costa County and ChangeMakers Academy is in Solano County. Both county's minor population is robust at 348,000 and 134,000, respectively. The projected five-year, school age population is expected to decline slightly at 0.1% in Contra Costa County and a greater 2.2% in Solano County 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, profitability levels and trends, substitution risk, and growth trends observed in the industry. We think the charter-school sector represents a moderately high credit risk compared with other industries and sectors.

Market position

Caliber has grown quickly and maintains a good position in the local market, despite the school's short history of operations. Enrollment has grown materially with the opening of the ChangeMakers campus in 2016, which resulted in enrollment growth of over 20%. Enrollment in fall 2019 grew to 1,616, (5.5% growth) and projections indicate more moderate growth of around 1.5% as the school reaches its target enrollment of 1,800 by 2023. Caliber has a decent waitlist constituting 78% of enrollment in fall 2019. Student retention is solid at 87% for ChangeMakers and 91% for Beta, which we believe is partially attributed to the populations that both schools serve.

Caliber is a good performer academically and outperforms competitors in the local school districts (Vallejo City Unified School District and West Contra Costa Unified School District) under the California Assessment of Student Performance and Progress. Test scores are closer to state averages in reading and math. We view the academic strength positively given the relatively higher needs student population that Caliber serves, which is not reflected in the state assessment scores.

Each campus for Caliber is chartered separately. Beta is authorized by Contra Costa County Office of Education and was granted its initial charter in 2014. The charter was most recently renewed in 2019 for a maximum possible term of five years, with a current expiration date of June 30, 2024. ChangeMakers is in its initial charter term, which was initially granted in 2016 and extends to June 30, 2021. Based on conversations with both authorizers, we believe that Caliber maintains a very good working relationship with its authorizers.

Caliber serves a wide range of cultures and socio-economic backgrounds. The school targets an underserved segment of the community, which we believe the school has successfully navigated and will continue to do so. As of 2018-2019,

approximately 70% of Caliber's student body was eligible for federal free or reduced-price meals (FRL) program and more than 90% of students are of color.

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

Base per pupil funding totaled \$8,966 in fiscal 2018 and increased modestly to \$9,078 in fiscal 2019. We understand that state per-pupil funding will grow just modestly at the cost of living adjustment rate now that Local Control Funding Formula (LCFF) gap funding has reached 100%. However, we understand that the school also serves a higher FRL population and qualifies for SB740 facilities grant program funding. This provides an additional \$750 per pupil to reimburse up to 75% of annual facilities rent and lease costs for charter schools that have 55% or more FRL students and give preference to students within the service area, which we view positively.

On Oct. 3, Gov. Gavin Newsom signed AB1505 into law, which represents a substantive change to the state's charter school laws since they were first enacted in 1992. The credit impact, if any, of the bill's provisions on existing charter schools, such as Caliber, are unknown at this time. Potential credit influences on our rating could include the phase-in of stricter credentialing requirements for teaching staff, which could pressure Caliber's operating expenses. Additionally, the bill's provisions allow for longer, seven-year renewals for high performing charter schools under a more streamlined process, but conversely, low-performing districts could face more difficulty obtaining renewals. Ultimately, we believe AB1505 increases charter school accountability, and we will monitor AB1505 and any future legislative initiatives for potential credit implications.

Management and governance

Caliber is governed by a six-member board of directors, with a seventh member joining in December 2019. The board can include up to 13 directors, including one parent representative. Members can serve up to two consecutive three-year terms. The average term of board members is approximately four years. Board skill sets vary across finance, education, technology and real estate. The board sets the policy for the network and monitors and oversees the CEO of Caliber schools.

Despite a recent change in leadership, we view Caliber's management team as experienced and capable. In December 2018, the co-founding CEO announced she would be transitioning from her role and after a six-month search process, the board recruited a new CEO, Terence Johnson, to help lead the school. The management team also consists of a chief schools officer, chief operating officer, head of talent, and upper and lower school leaders. Leadership has a significant number of years of experience working with charter schools, which is reflected by the positive feedback from the school's authorizers. Caliber is structured with a central management office that provides financial, administrative, data analytics, and talent management support. Additionally, the school has established a short track record of fundraising, which could support the organization with financial flexibility in the future, if the school were able to grow students to levels where it were not reliant on philanthropy.

Financial Profile

Financial performance

Caliber has maintained positive operations on a full-accrual basis since inception, despite the rapid level of growth over its short operating history. For fiscal year-end June 30, 2018, the school produced a nearly \$2.4 million surplus (13% excess margin) and has maintained margins above 10% over the past three years. We understand the school has received large amount of philanthropic grants (over \$3 million in the past few years), which was to help fund the opening of the ChangeMakers campus. Management anticipates a more modest surplus in fiscal 2019, due to more modest fundraising, which is expected to normalize going forward. For fiscal 2020, Caliber is budgeting for breakeven, or slightly deficit operations driven primarily by the increasing expenses due to additional students. We believe management budgets conservatively and could outperform projections depending on philanthropy and donations received. We understand management is focused on attracting longer commitments (three-years plus).

Pro forma lease-adjusted MADS coverage based on fiscal 2019 projections is 1.23x, which we believe is more accurate depiction of coverage based on normalized fundraising levels. MADS includes both the EFF loan and the Proposition 51 loan, although we understand the Proposition 51 loan will not start until fiscal 2023 when the facility is completed, which gives Caliber some time to grow enrollment at the ChangeMakers campus. Pro forma MADS coverage based on fiscal 2020 is projected to decline to 0.85x based on increasing expenses, but is stronger at 1.05x including the EFF loan only. Despite some fluctuations, we expect the school will maintain coverage around 1.00x, over the next few years.

Liquidity and financial flexibility

Caliber ended fiscal-year 2018 with 95 days' cash on hand, which we view as good for the rating. There has been some volatility in this metric due to growing expenses from increasing student enrollment. Liquidity is expected to rise slightly to 106 days' due to the school's surplus operations in fiscal 2019, and then fall to 83 days' based on fiscal 2020 projections. We expect the school's liquidity to stabilize at this level going forward. Pro forma unrestricted reserves as a percentage of debt was 19.2%, for fiscal 2019, which we also view as good for the rating.

Debt burden

Caliber's pro forma long-term debt outstanding is \$27.3 million, including both the EFF loan and Proposition 51 loan. The pro forma MADS burden is what we would consider manageable at 8.2% of fiscal 2019 revenue. Pro forma debt to capitalization is moderately leveraged at a 77% debt to capitalization rate. The school has no additional contingent liabilities or off-balance sheet debt. We do not expect additional debt within the outlook period.

According to information provided, bondholders receive operating and liquidity covenants. Liquidity and operating covenants require maintaining 45 days' cash on hand and 1.1x annual debt service coverage on a consolidated basis. Covenant violations require engaging a management consultant that is acceptable to the issuer, yet they do not constitute a technical default unless DSC falls below 1.0x. We understand that management fees can also be subordinated in the event that coverage is unable to meet 1.1x.

Financial policies

The school has formal policies for liquidity and debt. Caliber meets standard annual disclosure requirements. The financial policies assessment reflects our opinion that, while there may 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, and legal structure, and a comparison of these policies with those of comparable providers.

Caliber Schools, Calif.: Enterprise And Financial Statistics

	--Fiscal year ended June 30--					--Medians for 'BB+' rated charter schools--
	2019*	2018	2017	2016	2015	2018
Enrollment						
Total headcount	1,532	1,267	1,041	N.A.	N.A.	1,147
Total waiting list	1,366	1,210	393	N.A.	N.A.	MNR
Waiting list as % of enrollment	89.2	95.5	37.8	N.A.	N.A.	18.5
Financial performance						
Accounting standard	N.A.	FASB	FASB	FASB	FASB	N.A.
Total revenues (\$000s)	19,012	17,883	14,527	8,833	5,050	13,409
Total expenses (\$000s)	18,124	15,498	12,781	7,403	3,568	MNR
EBIDA (\$000s)	917	2,423	1,777	1,448	1,482	MNR
EBIDA margin (%)	4.80	13.50	12.20	16.40	29.30	14.90
Excess revenues over expenses (\$000s)	888	2,385	1,746	1,430	1,482	MNR
Excess income margin (%)	4.70	13.30	12.00	16.20	29.30	3.40
Operating lease expense	995	551	294	N.A.	N.A.	MNR
Pension/OPEB adjustments (\$)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Lease adjusted annual debt service (\$)	N.A.	559	1,057	N.A.	N.A.	MNR
Lease-adjusted annual debt service coverage (x)	N.A.	5.32	1.96	N.A.	N.A.	MNR
Lease-adjusted annual debt service burden (% total revenues)	N.A.	3.10	7.30	N.A.	N.A.	MNR
Lease-adjusted MADS (\$000s)	N.A.	N.A.	N.A.	N.A.	N.A.	1,686
Lease-adjusted MADS coverage (x)	N.A.	N.A.	N.A.	N.A.	N.A.	1.40
Lease-adjusted MADS burden (% total revenues)	N.A.	N.A.	N.A.	N.A.	N.A.	13.1
Pro forma MADS (\$000s)	1,551	1,551	N.A.	N.A.	N.A.	MNR
Pro forma lease-adjusted MADS coverage (x)	1.23	1.92	N.A.	N.A.	N.A.	MNR
Pro forma lease-adjusted MADS burden (% total revenues)	8.20	8.70	N.A.	N.A.	N.A.	MNR
Total revenue per student (\$)	12,410	14,114	13,955	N.A.	N.A.	MNR
Balance sheet metrics						
Unrestricted reserves (\$)	N.A.	4,015	2,763	2,913	1,979	MNR
Days' cash on hand	N.A.	94.74	78.93	143.70	202.45	102.00
Total long-term debt (\$000s)	N.A.	N.A.	N.A.	760	150	MNR
Unrestricted reserves to debt (%)	N.A.	N.A.	N.A.	395.80	1,319.30	16.90
Unrestricted net assets as % of expenses	43.90	50.00	41.90	48.80	61.00	24.90

Caliber Schools, Calif.: Enterprise And Financial Statistics (cont.)

Enrollment	--Fiscal year ended June 30--					--Medians for 'BB+' rated charter schools--
	2019*	2018	2017	2016	2015	2018
Debt to capitalization (%)	N.A.	N.A.	N.A.	N.A.	N.A.	86.00
Debt per student (\$)	N.A.	N.A.	N.A.	N.A.	N.A.	15,524
Pro forma metrics						
Pro forma unrestricted reserves (\$000s)	5,244	4,015	N.A.	N.A.	N.A.	MNR
Pro forma days' cash on hand	106	95	N.A.	N.A.	N.A.	MNR
Pro forma long-term debt (\$000s)	27,258	27,258	N.A.	760	150	MNR
Pro forma unrestricted reserves to debt (%)	19.20	14.70	N.A.	N.A.	N.A.	MNR
Pro forma debt to capitalization (%)	77.00	78.00	N.A.	17.00	6.00	MNR
Pro forma debt per student (\$)	17,792	21,514	N.A.	N.A.	N.A.	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 re

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