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New Jersey Economic Development Authority
Ashland School Inc.; Charter Schools

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Rationale

S&P Global Ratings affirmed its 'BBB' rating on the New Jersey Economic Development Authority's series 2018A tax-exempt and series 2018B taxable revenue bonds, issued for the Friends of TEAM Academy Charter Schools (FOTA) on behalf of TEAM Academy Charter School Inc. (TEAM). At the same time, we affirmed our 'BBB' rating on the New Jersey Economic Development Authority's series 2013 revenue bonds issued for Ashland School Inc. (Ashland), also on behalf of TEAM. The outlook on all bonds is stable.

We assessed TEAM's enterprise profile as strong, characterized by managed enrollment growth, solid demand with a moderate waiting list and good academics, and a sophisticated and highly capable management team. We assessed TEAM's financial profile as adequate, supported by consistently positive operating performance and sufficient lease adjusted maximum annual debt service (MADS) coverage, offsetting its high leverage, both on an absolute and per-student basis, and modest days' cash on hand. We believe that combined, these credit factors lead to an indicative stand-alone credit profile of 'bbb' and a final rating of 'BBB'.

TEAM has plans to add new schools and campuses over the next several years. Associated with this growth, we understand the organization may have potential for future debt, depending on the availability of facilities and how quickly the planned growth materializes. In our view, given the steadiness of TEAM's operating results, supported by a history of solid enrollment growth, healthy fundraising, and a rising revenue base, we believe there is some debt capacity at the rating level. We expect to evaluate additional debt plans as details emerge.

The rating also reflects our view of TEAM's:

- Growing enrollment, historically strong demand, and a solid market position, reflected by a robust and rising waiting list at about 50% of enrollment;
- History of healthy operating surpluses generating good lease-adjusted MADS (gross of tax credit subsidies), with a

manageable debt burden and similar results expected for fiscal 2019;

- History of good academic performance, supported by unique programming that provides teacher training resulting in high teacher retention, as well as robust mentorship opportunities for students and alumni;
- Sophisticated management team with sound governance practices, good fundraising history, and thoughtful strategic planning; and
- Good working relationship with the chartering authority, the New Jersey Department of Education (NJDOE), and a history of successful charter renewals.

Factors currently precluding a higher rating consist of weaknesses that we believe are specific to the academy, as well as those intrinsic to charter schools in general. These factors include:

- High leverage, both on a balance-sheet and per-student basis, although TEAM has received, and is entitled to continue to receive, a significant amount of federal tax credit bond subsidies, which offset about 50% of the debt service payments on currently outstanding debt;
- Modest unrestricted reserves for the rating level, with 102 days' cash on hand at the end of fiscal 2019;
- Risk associated with considerable growth plans, although TEAM has managed significant growth successfully in recent years;
- Potential pressure from pension plans, which are poorly funded at the state level, and the state's fiscal stress, which could pressure per-pupil funding in upcoming years;
- Complicated debt structure involving a third-party borrower and security based on the automatically renewable lease with the school, due to state charter school law;
- Potential lease risk associated with several of TEAM's current and future facilities, as the leases expire before the final maturity on the bonds; and
- The inherent uncertainty associated with charter renewals, given that the final maturity on the bonds exceeds the length of the existing charter.

TEAM is a New Jersey not-for-profit corporation formed in 2002, affiliated with the national KIPP organization. It launched operations in the fall of that year with its first middle school, TEAM Academy. Today, TEAM comprises a network of public, college-preparatory charter schools serving Newark's under-resourced communities, with current enrollment of just above 4,700 for fall 2019. For the 2019-2020 academic year, TEAM is operating 11 schools under its charter: five elementary schools serving grades K-4 at full enrollment--SPARK Academy, THRIVE Academy, Seek Academy, Life Academy, and Upper Roseville Academy; four middle schools serving grades five through eight at full enrollment--TEAM Academy, Rise Academy, BOLD Academy, and Newark Community Prep; and two high schools, Newark Collegiate Academy and Newark Lab High School. The schools are organized in clusters of five schools (two elementary, two middle and one high school), with different facilities within approximately three miles of each other to offer a full grade K-12 education. In fall 2019, TEAM executed on part of its growth strategy, with the successful expansion of a new elementary school, middle school and high school. This completed two clusters of five schools each, as well as the first elementary school associated with TEAM's third cluster of five schools. The NJDOE's most recent charter renewal for TEAM includes approval for enrollment growth that is consistent with TEAM's strategy, allowing for an enrollment cap of 7,920 and expansion to 15 schools.

FOTA, a single-purpose New Jersey not-for-profit corporation, used the series 2018 bond proceeds, with a par of about $59.3 million, to refund existing bank obligations for reduced interest costs, reimburse TEAM for the cost of acquisition of an existing school building at 300 North 13th Street (the Upper Roseville building), and fund capital improvements at the Upper Roseville building, 129 Littleton Avenue (owned by a separate single-purpose entity supporting TEAM) and 103 Bragaw Avenue (long-term lease with Newark Public Schools). The Littleton Avenue and Bragaw Avenue projects were completed on time and on budget during summer 2019. The Upper Roseville project is still underway.

Ashland, a similarly organized single-purpose New Jersey not-for-profit corporation, used the series 2013 bond proceeds to acquire two of TEAM's school facilities. Ashland is leasing the facilities to TEAM structured as five-year leases that automatically renew after each five-year term, corresponding with the length of the charter. This unique lease structure stems from New Jersey charter school law, which prevents charter schools from entering into leases that exceed the term of the charter or incurring long-term debt related to construction. Ashland used the series 2013 bond proceeds, approximately $20 million in fixed-rate debt, to purchase two existing facilities that house TEAM Academy and Rise Academy from FOTA, which had originally incurred bank debt and purchased these facilities. FOTA used the proceeds from Ashland to pay down all outstanding debt associated with acquiring these facilities and as equity for other facility projects. Ashland also borrowed $2.75 million of proceeds from previously, unrated, taxable qualified zone academy bonds (QZAB) and qualified school construction bonds (QSCB), under which the federal government subsidizes interest expense as part of a federal bond program, to finance facility improvements at Rise Academy.

The series 2018 bonds are essentially on parity with the series 2013 bonds with substantially similar security provisions, despite separate single-purpose entities as borrowers. The series 2018 bonds are secured by an absolute assignment of QZAB and QSCB debt service payments, which are funded through TEAM lease payments and QZAB/QSCB direct pay subsidy payments, a mortgage on the Upper Roseville building and a debt service reserve fund (DSRF). The series 2013 bonds are secured by an absolute assignment of lease payments from TEAM to Ashland, a DSRF, and a support agreement with FOTA whereby FOTA agrees to guarantee debt service on the 2013 bonds. All debt of the TEAM organization is ultimately serviced by loan or lease payments made by TEAM to the single-purposes entities, which we view as equivalent to a general revenue pledge of all TEAM schools. Further, the terms of the lease agreement between TEAM and Ashland, require TEAM to make bi-monthly lease payments equaling 120% of bond debt service to the trustee. Because of details of the lease structure and security features associated with the series 2018 and series 2013 bonds, we view the bonds as a general obligation of TEAM and our analysis is prepared on a consolidated basis.

While FOTA and other single-purpose entities hold the long-term debt, our analysis reflects total debt across all entities and is referred to throughout this report as debt of the TEAM organization for simplicity. As TEAM and its supporting single-purpose entities are separate and distinct legal entities, there is no regulatory requirement to consolidate financial statement presentation. However, given our analytical approach, combined information is presented to support our ability to understand TEAM's overall financial picture. The fiscal 2019 results are based on internal unaudited figures, with a consolidated presentation provided by TEAM.

As of June 30, 2019, TEAM and its supporting organizations had approximately $102.6 million of long-term fixed-rate debt outstanding. TEAM has several bank loans, which we view as contingent debt, with covenants that are consistent with existing debt terms; the loans are not cross-defaulted and we understand covenant violations do not result in immediate acceleration. In our view, TEAM has ample headroom above financial covenants and we view the risk of acceleration as remote at this time. The facilities for Newark Collegiate, TEAM, THRIVE, Rise, and BOLD academies are owned by respective single-purpose entities, while the buildings for SPARK and Life academies are leased on a long-term basis. Seek Academy is currently in a Newark Public Schools (NPS) building on a short-term lease which TEAM anticipates extending. TEAM plans to similarly use a combination of leased and owned facilities for its new schools, and management notes there is excess capacity at its current facilities to house the initial stages of the planned expansion. Beyond this, we understand that there are potential future debt plans that will fund new facility acquisitions and capital improvements to existing facilities to support the planned growth.

Outlook

The stable outlook reflects our expectation that, over the next two years, TEAM will continue to generate operating surpluses and generally maintain financial metrics sufficient for the rating, though we do expect some level of moderation in operating surpluses from historic levels. In addition, we expect TEAM will maintain steady demand at each campus location, at least stable liquidity, and prudent management of future expansion and potential debt plans.

Downside scenario

We could consider a negative rating action if liquidity or MADS coverage weaken to levels inconsistent with the rating category. In addition, we believe the organization has only modest capacity for additional debt at the current rating level and significant additional debt could result in a negative rating action. Finally, any enrollment or funding pressures resulting in sustained operating deficits with materially weakened MADS coverage could be viewed negatively.

Upside scenario

A positive rating action is unlikely during the next two years given our opinion of TEAM's leverage, modest unrestricted reserves, and expected expansion and potential debt plans.

Enterprise Profile

Economic fundamentals

TEAM is in Essex County, which includes a healthy minor population at about 265,000. The minor population is expected to decline modestly, by a projected 3.3%, through 2024, though in our view the large minor population anchors this assessment and the school's reputation generates good demand offsetting risks of a declining population.

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

Overall, we consider TEAM's enrollment and demand profile stable and solid, based on its consistently growing enrollment, above-average academic performance, and good student retention. TEAM's enrollment has increased every year since inception through grade expansion and additional schools. Total enrollment has more than doubled over the past six years, with current total enrollment for fall 2019 (enrollment figures will be finalized on count day, October 15th) across all 11 schools jumping 8.3% to 4,733 from 4,369 the prior year.

TEAM maintains a good waiting list, which outside of a one-year dip in fall 2016, was above 2,000 students in recent years and is healthy at every grade level. TEAM participates in NPS' universal enrollment system (One Newark Enrolls [ONE]), which allows parents to complete a single application for both district and charter schools with a ranking for their top eight schools. According to management, approximately 10% of all applicants ranked TEAM schools first, which, in our view, reflects TEAM's solid demand profile. Retention rates across the TEAM schools have been good, averaging near 93% for the past few years. TEAM draws from a low-income population, with 85% to 90% of its students qualifying for free or reduced lunch and a special education population ranging between 7% and 17%, depending on the school--higher on average than those of comparable Newark charter schools. The TEAM schools differ somewhat in their respective competitive positions because of grades served, location, and access to public transportation, although we view the demand for all campuses as healthy. We anticipate TEAM will maintain a steady enrollment and demand profile for the near-term.

Based on management's projections and growth strategy, by adding new schools and filling in grade levels at the existing schools, TEAM plans to increase enrollment steadily until reaching just over 8,400 students across the network by fall 2030. Over the next few years, TEAM projects enrollment will grow between 7% and 10% annually. We view TEAM's enrollment growth plans as manageable given the strength of its demand profile and robust waiting list levels. In our view, the organization has managed its recent growth very successfully, with a proven track record of effectively managing the opening of new schools and meeting enrollment targets.

TEAM's academic performance has historically been good, outperforming Newark Public Schools and with performance comparable to the area's top charter schools. In addition, recent testing results for the 2018-2019 school year demonstrate performance that now either approaches or exceeds state averages, which we view as remarkable given that the schools in other areas of the state are generally high performing. While test scores vary by school and grade, overall performance has generally indicated improvement over time as students stay with TEAM and advance through the grades. We expect this trend will continue and expect the TEAM's good academic outcomes will continue to support solid demand for the network. TEAM's high school curriculum has a special emphasis on preparedness for higher education, with a robust college counseling program that starts during freshman year. Newark Collegiate has graduated four senior classes, with an impressive 100% graduation rate and 84% college acceptance rate for the class of 2019. TEAM's academic program is supported by dedicated teachers and staff, with a good teacher retention rate.

The NJDOE provides academic and financial oversight as the school's charter authorizer and states that TEAM exhibits good financial compliance and academic outcomes. NJDOE granted the school's initial charter in 2002 for a four-year term and has renewed it three times for five years each (charters in New Jersey are generally renewed for five years), with the most recent five-year renewal extending through June 30, 2021. New Jersey laws governing charter schools are stricter than those of many other states; the state recently adjusted its charter renewal process to include a contract between the NJDOE and each charter school. The charter renewal process includes set benchmark targets for each charter school--which, if not met, could result in the charter's revocation at the end of its term. There are no concerns related to TEAM's charter at this time. The statutory framework assessment reflects our opinion that, while there may be some areas of risk, the framework is not likely to impair its future ability to pay debt service.

Management and governance

TEAM is managed by KIPP New Jersey, a management organization created to support the TEAM schools in Newark and KIPP Cooper Norcross Academy in Camden, in southern New Jersey. In fall 2018, KIPP New Jersey also began managing KIPP Miami. Currently, KIPP New Jersey manages three schools (with plans to grow to five) in Camden and two schools (with plans to grow) in Miami. KIPP Cooper Norcross and KIPP Miami operate under their own charters and are separate legal and financial entities from TEAM. TEAM, KIPP Cooper Norcross and KIPP Miami have executed separate management agreements with KIPP New Jersey; TEAM's contract is for a two-year term and will renew thereafter in two-year increments.

In our view, KIPP New Jersey consists of a dynamic and dedicated senior management team, with several long-tenured members as well as newer staff added to support strategic growth. Management indicates a succession plan is in place, coupled with cross-training and shared support of responsibilities, in the event of any changes. Its current five-member volunteer TEAM Academy board of trustees will increase back up to nine members in October and has a standard committee structure providing additional oversight. The board members possess expertise in a variety of areas, including business and education, along with a strong community presence, which we believe adds stability to school operations and provides support for continued growth plans over the next several years. In addition, FOTA is governed by an independent eight-member board that has--with the support of KIPP New Jersey's board, executive leadership and development staff, as well as TEAM's board--very successfully fundraised to support TEAM's past and planned expansion. We view the school's strong fundraising history and board network as positive credit factors, supporting TEAM's financial flexibility. In our view, management has handled its growth and strategic plans deliberately while maintaining sound financial and operational oversight.

Financial Profile

State funding environment

Overall, per-pupil funding for TEAM was flat in fiscal years 2018 and 2019, and will remain flat for fiscal 2020. Long term, we anticipate there could be funding pressures due to the state's fiscal stress. We understand management is preparing accordingly and expects to manage funding levels through enrollment growth and expense reductions.

Financial performance

TEAM has reported positive operations on a consolidated basis since its founding, with healthy margins largely reflecting disciplined expense control, continued enrollment growth, and stable-to-increasing per-pupil funding. For fiscal 2018, TEAM posted an EBIDA margin of 16% and an operating surplus of $4.3 million (4.8% margin), which is slightly moderated from prior levels, but expected to be more indicative of future trends given the funding environment. Based on internal unaudited results, which could differ from full accrual consolidated results in the final audited presentation, TEAM reported a $4.5 million surplus for fiscal 2019, in line with prior year.

As stated earlier, TEAM utilizes a number of federal tax credit bonds, which include the payment of a subsidy to offset interest cost on a significant portion of the school's outstanding debt. Our analysis reflects a conservative calculation based on gross MADS of $11.3 million (includes the full debt service payment required and not adjusted for the annual subsidy), TEAM's positive operations supported good lease-adjusted MADS coverage of 1.5x in fiscal 2018. Based on net MADS of $7.3 million (reflecting a reduction in debt service associated with the annual subsidy payments), we calculate fiscal 2018 MADS coverage at a healthier 1.6x. Based on unaudited figures shared for fiscal 2019, coverage of gross MADS would be consistent at approximately 1.6x and coverage of net MADS would be approximately 1.8x. Management projects continued surpluses in the near term, though surpluses may moderate slightly from historical levels given the recent and expected trends in per-pupil funding. Typically TEAM has significantly outperformed budgeted expectations and therefore we expect performance will remain at a level sufficient for the rating.

Liquidity and financial flexibility

Good cash flow, healthy fundraising, and positive bottom lines have supported TEAM's stable liquidity. Based on audited results as of June 30, 2018, TEAM had $21.9 million of unrestricted cash and investments, or 98 days' cash on hand, which we view as sufficient for the rating. While unrestricted reserves are growing year over year, we recognize the days' cash on hand metric has remained largely stagnant due to TEAM's growing expense base. Based on unaudited results for fiscal 2019, days' cash on hand increases slightly to approximately 102 days, by our calculations. TEAM's unrestricted reserves to debt metric is generally improving year over year, but remains modest compared with category medians and comparable peers. We expect TEAM's unrestricted reserves to debt to remain relatively steady in coming years as unrestricted cash grows and the organization pays down existing debt, but offset by potential additional debt plans. On the positive side, based on net debt and adjusting for subsidy entitlement, TEAM's unrestricted reserves to debt metric is substantially higher than category median.

Debt burden

As of June 30, 2019, TEAM's long-term debt was approximately $102.6 million. In our view, this translates to a manageable gross and net MADS burden at 11.4% and 7.4%, respectively, of fiscal 2019 operating revenues and moderate debt-to-capitalization, though we consider leverage high on both an absolute and per-student basis, which limits substantial debt capacity at the current rating. We do recognize on a net basis, total long-term debt as of June 30, 2019, was $52.3 million, recognizing the $50.3 million present value of remaining tax credit subsidy entitlement, which offers some flexibility. As stated, given the potential plans for additional debt in the near-term we expect these metrics may moderate somewhat but will likely remain in line with the rating.

Our debt burden analysis also reflects potential exposure associated with the state's significantly underfunded pension plans. The school participates in cost-sharing multiple-employer pension plans: the Teachers' Pension and Annuity Fund (TPAF) and the Public Employees Retirement System (PERS). TPAF, the largest plan in which the school participates, has a special funding situation, whereby the state makes all payments to the plan on behalf of local employers. While currently 100% of employer contributions are made by the state, we recognize there is potential that the state could shift obligations to the school. The plan fiduciary net position as a percent of the total pension liability, as defined in GASB Statement No. 67, was 26.49% for TPAF and 40.45% for PERS as of June 30, 2018.

Although we expect higher actuarially determined contributions (ADC) to stabilize the GASB pension-funded ratios during the next few fiscal years, we expect them to remain low for some time; they could backslide if weak economic conditions were to cause the state to lower ADC funding. GASB calculates lower blended assumed rates of return following projected cash depletion in 2047 for PERS and 2041 for TPAF; cash depletion partially occurs because the actuaries' GASB 67 valuations assume the 50% ADC funding in fiscal 2018 continues for all future years. While the academy's pension and other-postemployment-benefits costs are limited to minimal costs associated with employees in PERS, we think the state's continued pension-funding problems could create budgetary stress for the school, particularly if New Jersey moves away from fully supporting TPAF costs. (For more information on pension plans, please see the New Jersey analysis' pension liabilities section, published May 7, 2019, on RatingsDirect.)

Financial policies

The school has a formal investment policy and 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 impair 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 comparison of these policies with comparable providers.

Bond provisions

According to documents provided to S&P Global Ratings, bondholders are provided operating and liquidity covenants, which vary slightly between the 2013 bonds and the 2018 bonds. The highest bond liquidity covenant requires TEAM to maintain unrestricted cash and investments of at least 15% of cash operating expenses; the highest bond operating covenant requires annual debt service coverage of 1.2x. Violations of these covenants require engaging a management consultant that is acceptable to the issuer, but do not constitute technical defaults unless coverage falls below 1x. A prospective additional bonds test is also included, requiring pro forma annual debt service coverage of at least 1.1x the most recent year's results, or pro forma annual debt service coverage of 1.2x or greater for one year following the new debt issuance. TEAM is in compliance with all bond covenants.

Ashland School (TEAM Academy), New Jersey Enterprise And Financial Statistics

	--Fiscal year ended June 30--				Medians for 'BBB' rated charter schools
	2020	2019*	2018	2017	2018
Enrollment					
Total headcount	4,733	4,369	4,064	3,702	2,354
Total waiting list	2,211	2,308	2,400	968	MNR
Waiting list as % of enrollment	46.7	52.8	59.1	26.1	51.3
Financial performance					
Total revenues ($000s)	N.A.	99,652	90,006	87,115	25,383
Total expenses ($000s)	N.A.	95,167	85,725	83,460	MNR
EBIDA ($000s)	N.A.	15,852	14,370	13,488	MNR
EBIDA margin (%)	N.A.	15.9	16.0	15.5	15.8
Excess revenues over expenses ($000s)	N.A.	4,485	4,281	3,655	MNR
Excess income margin (%)	N.A.	4.5	4.8	4.2	6.3

Ashland School (TEAM Academy), New Jersey Enterprise And Financial Statistics (cont.)

	--Fiscal year ended June 30--				Medians for 'BBB' rated charter schools
	2020	**2019***	**2018**	**2017**	**2018**
Operating lease expense	N.A.	2,467	2,530	2,693	MNR
Lease-adjusted annual debt service coverage (x)	N.A.	1.84	1.59	1.50	MNR
Lease-adjusted annual debt service burden (% total revenues)	N.A.	10.0	11.8	12.4	MNR
Lease-adjusted annual debt service burden (% total expenses)	N.A.	10.5	12.4	12.9	MNR
MADS ($000s)**	N.A.	11,354	11,684	11,684	2,153
Lease-adjusted MADS coverage (x)	N.A.	1.61	1.45	1.38	1.90
Lease-adjusted MADS burden (% total revenues)	N.A.	11.4	13.0	13.4	8.4
Total revenue per student ($)	N.A.	22,809	22,147	23,532	MNR
Balance sheet metrics					
Days' cash on hand	N.A.	102.00	97.89	82.56	181.80
Total long-term debt ($000s)	N.A.	102,638	87,398	92,474	MNR
Unrestricted reserves to debt (%)	N.A.	24.5	24.0	19.1	42.6
Unrestricted net assets as % of expenses	N.A.	63.6	65.0	59.8	60.0
Debt to capitalization (%)	N.A.	64.2	62.4	65.6	67
Debt per student ($)	N.A.	23,492	21,692	24,559	11,482

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) *Based on internal unaudited results. **Presented on a gross MADS basis; for fiscal 2019, using net MADS, coverage was 1.8x and the lease-adjusted MADS burden (% total revenues) was 7.4%.