S&P Global Ratings

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KIPP Nashville, Tennessee; Charter Schools

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Credit Profile		
ICR		
Long Term Rating	BBB-/Stable	New

Rationale

S&P Global Ratings assigned its 'BBB-' issuer credit rating (ICR) and stable outlook to KIPP Nashville, Tenn.

We assessed KIPP Nashville's enterprise profile as adequate with solid demand, characterized by its high enrollment growth, decent student retention, and above-average academic performance. We assessed KIPP Nashville's financial profile as adequate, characterized by its financial profile metrics, solid pro forma lease-adjusted maximum annual debt service (MADS) for the rating, sufficient days' cash on hand, and history of positive full-accrual operating performance. Combined, these credit factors led to an indicative stand-alone credit profile of 'bbb-' and final rating of 'BBB-'.

We understand the school has additional debt and expansion plans during the next few years that inherently expose it to growth risk that has the potential to pressure its credit profile. We will assess the full scope and potential effect of additional debt on KIPP Nashville once it finalizes details.

The rating reflects our opinion of the school's:

- Solid enterprise profile with sound academic performance, growing enrollment, and healthy retention;
- Historically positive operations with expectations for positive performance for fiscal 2019;
- Healthy pro forma lease-adjusted MADS coverage of 1.58x based on audited fiscal 2018 results; and
- Good cash for the rating, with 145 days' cash on hand for fiscal 2018.

We believe somewhat offsetting factors are, what we consider, KIPP Nashville's:

- Rapid expansion plans, which inherently present some uncertainty;
- Heightened debt due to its adding significant debt to fund expansion; and
- Risk, as with all charter schools, that the charter authorizer could close it for nonperformance of its charter or financial distress before the bonds' final maturity.

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. KIPP Nashville has acquired two campuses, encompassing four schools. The remaining three existing schools operate out of leased facilities. KIPP Nashville financed the owned campuses through privately placed bonds held by Pinnacle Bank. In November 2017, KIPP Nashville issued $6.5 million of series 2018 bonds.

KIPP Nashville is the second charter school to open in Nashville. It began with a middle school, KIPP Academy Nashville, in 2005 with 50 students. Since then, it has opened five additional schools with an additional school opening in fall 2019. Of the seven total schools, five complete the first kindergarten through 12th-grade (K-12) cluster on the north and east sides of Nashville--Highland Heights, Kilpatrick, and Ewing Park--and two have started to form a second K-12 cluster on the southeast side of Nashville in Antioch. To complete the second K-12 cluster, KIPP Nashville needs three additional schools, the charters of which it will apply for during the next 24 months. KIPP Nashville serves 2,038 K-12 students as of fall 2018.

Outlook

The stable outlook reflects S&P Global Ratings' opinion that during the next two years, management will likely meet budgeted enrollment projections and maintain positive full-accrual operations, allowing it to sustain MADS coverage and cash consistent with the current rating.

Downside scenario

We could lower the rating or revise the outlook to negative if the school does not meet enrollment projections such that financial performance were to deteriorate, cash were to decrease, and lease-adjusted MADS were to weaken. In addition, if KIPP Nashville were to issue additional debt that materially impairs financial operations and debt, we could lower the rating or revise the outlook to negative.

Upside scenario

Although unlikely to occur during the two-year outlook period due to the school's expansion and additional debt plans, we could raise the rating or revise the outlook to positive during the longer term if the school were to strengthen its financial profile and maintain healthier full-accrual operating surpluses such that lease-adjusted MADS coverage were to improve significantly while demonstrating growing enrollment, further strengthening its enterprise profile to levels we consider commensurate with a higher rating.

Enterprise Profile

Economic fundamentals

KIPP Nashville is in Davidson County in Nashville. The county is the state's second-most populous county. The county's minor population is about 230,000. The projected five-year, school-age population growth rate is 2.8% through 2024.

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, 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

We view KIPP Nashville's enrollment-and-demand profile as sound, supported by significant enrollment increases and a history of solid retention. Total enrollment grew by more than 28% in fall 2018 from fall 2017; enrollment has doubled during the past four years due to the addition of new schools. In July 2013, KIPP Nashville opened KIPP Nashville College Preparatory Middle School. In July 2014, KIPP Nashville opened KIPP Nashville Collegiate High School and KIPP Kirkpatrick Elementary School. KIPP Nashville opened KIPP Nashville College Preparatory Elementary School in July 2017. This completed the first of two clusters. In July 2018, KIPP Nashville opened KIPP Antioch College Preparatory Elementary School. KIPP Nashville expects to open KIPP Antioch College Preparatory Middle School in July 2019, followed by the addition of three new schools in southern-eastern Nashville, completing cluster two.

In total, KIPP Nashville expects to operate 10 schools by fall 2023 with an estimated 4,504 students. Student enrollment is currently 2,038 for all six existing schools. The schools' total waitlist was 305 in fall 2019, which represents about 15% of total enrollment; this number, however, is understated, in our opinion. The current waitlist includes only potential students who listed the school as their first choice. KIPP Nashville's retention has been excellent, in our view: It was 93% in fall 2018. We expect management to maintain a healthy demand profile and continue to grow enrollment as new schools come online.

KIPP Nashville outperforms the local school district in all subjects, as well as the state in math and science. The high school ACT average score is above national and state averages, which we view positively.

We view the school's standing with the authorizer as good. KIPP Nashville has held its initial charter with Metro Nashville Public Schools, the authorizer, for more than 13 consecutive years; the authorizer recently renewed the charter for 10 years in 2015. The various schools in cluster one are all authorized by Metro Nashville Public Schools, and they have staggered terms depending on the initial authorization. The state authorized the two schools in the second cluster, both of which have 10-year terms. We spoke with the authorizers, and they both spoke highly of KIPP Nashville's management and performance.

The statutory framework assessment reflects our opinion that while there could be some areas of risk, the framework is not likely to negatively affect KIPP Nashville's future ability to pay debt service. Tennessee charter schools rely on the state for per-pupil funding. Per-pupil funding has increased by roughly 2.8% during the past three years, which we view favorably.

Management and governance

KIPP Nashville is self-managed with a dynamic and dedicated senior management team, including several long-tenured members. Discussions with management indicate a succession plan is in place, coupled with cross-training and shared support of responsibilities in the event senior leadership changes; however, we recognize no changes are currently planned.

An active 16-member volunteer board of trustees provides additional oversight. Board members possess expertise in a variety of areas, including business and education, coupled with a solid presence in the community we think adds stability to school operations and supports continued growth. In addition, through its executive leadership team, board, and development staff, KIPP Nashville has fundraised close to $11.8 million during the past four fiscal years through federal; state; and private grants, as well as philanthropic fundraising with individuals, foundations, and corporations. We view the school's healthy fundraising history and board network as positive credit factors, supporting KIPP Nashville's financial flexibility. In our view, management has been prudent in terms of growth and strategic planning while maintaining sound financial and operational oversight.

Financial Profile

Financial performance

KIPP Nashville has consistently reported positive operations with healthy margins largely attributable to disciplined expense control, continued enrollment growth, and stable-to-increasing per-pupil funding. For fiscal 2018, KIPP Nashville posted an EBIDA margin of 14% of operating revenue and an operating surplus of $2.1 million, or a 9.9% operating margin, a level we view as good for the rating.

Pro forma lease-adjusted MADS of about $2.263 million includes all debt service outstanding, as well as modest lease expenses associated with existing campuses. Pro forma lease-adjusted MADS coverage on KIPP Nashville's debt is good for the rating, in our view, at 1.58x based on fiscal 2018 results. We recognize this calculation is conservative because it layers on the effect of additional borrowings on debt service, without the benefit of revenue associated with additional students. Lease-adjusted MADS was modest, in our view, at about 10.6% of operating revenue for fiscal 2018. The fiscal 2019 budget calls for a modest surplus, reflecting KIPP Nashville's conservative budgeting. We expect the organization will likely maintain steady near-term financial performance, consistent with the rating.

Liquidity and financial flexibility

Ample cash flow, healthy fundraising, and positive bottom lines have supported KIPP Nashville's healthy liquidity. At June 30, 2018, KIPP Nashville had $7.3 million of unrestricted cash and investments, or 145 days' cash on hand, which we view as solid. However, despite unrestricted reserve growth, days' cash on hand is down from a high of 292 days' at fiscal year-end 2015 due primarily to growing expenditures. Overall, we expect liquidity will likely remain fairly steady with continued operating surpluses and healthy cash flow, offset by expenditure growth. We understand management does not currently plan to spend down reserves. We expect continued positive operating performance will likely assist KIPP Nashville in maintaining healthy liquidity.

Debt burden

In our view, KIPP Nashville has somewhat limited debt capacity beyond current discussions at the current rating; we consider its debt load high on both an absolute and per-student basis, partially mitigated by manageable pro forma lease-adjusted MADS still in-line with category medians and moderate debt-to-capitalization ratios. KIPP Nashville's pro forma long-term debt outstanding for fiscal 2019 is projected at $24.6 million. KIPP Nashville's growth-and-expansion plan calls for additional financing of $42.3 million between fiscal years 2021 and 2023. However, we understand any additional parity debt will likely have to meet 1.2x debt service coverage (DSC).

Bond provisions

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 DSC, respectively. 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 1x. Covenants also include a prospective additional bonds test that requires 1.2x projected DSC.

As with many charter schools, the organization's pro forma debt-to-capitalization ratio shows significant debt on the balance sheet. With the new debt issuance, the ratio was 82.58%. We view the school's debt as a constraining rating factor.

Total pro forma debt of $24.6 million includes the Equitable School Revolving Fund loan of $10.5 million. Management will use loan proceeds to refinance $6.5 million of debt with Pinnacle Bank--used to acquire the Ewing Park campus for KIPP Nashville College Preparatory elementary and middle schools--and provide about $3.5 million in new money for expansion and renovations, specifically adding third- and fourth-grade classrooms. The transaction's bond structure is straightforward with a pari passu--Latin for equal footing--security interest in all revenue streams and a senior security interest in Ewing Park campus.

Financial policies

The school has formal investment-allocation, liquidity, and debt policies. KIPP Nashville meets standard annual disclosure requirements. The financial policies assessment reflects our opinion that while there could be some areas of risk, the organization's overall financial policies are not likely to negatively affect its ability to pay debt service. Our analysis of financial policies includes a review of the organization's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure; we compare these policies with those of comparable providers.

KIPP Nashville, Tennessee Select Enterprise And Financial Statistics

	--Fiscal year-end June 30--					Medians for 'BBB-' rated charter schools
	2019p	**2018**	**2017**	**2016**	**2015**	**2017**
Enrollment						
Total headcount	2,038	1,591	1,290	1,050	648	1,056
Total waitlist	305	321	262	226	115	MNR
Waitlist as % of enrollment	15.0	20.2	20.3	21.5	17.7	18.5
Financial performance						
Total revenue ($000s)	N.A.	21,313	16,216	13,377	8,841	11,497
Total expenses ($000s)	N.A.	19,195	14,385	11,819	7,703	MNR
EBIDA ($000s)	N.A.	2,891	2,353	1,963	1,438	MNR
EBIDA margin (%)	N.A.	13.6	14.5	14.7	16.3	15.9
Excess revenue over expenses ($000s)	N.A.	2,118	1,831	1,558	1,138	MNR
Excess income margin (%)	N.A.	9.9	11.3	11.6	12.9	3.8
Operating lease expense	N.A.	679	648	659	575	MNR
Lease-adjusted annual debt service coverage (x)	N.A.	3.89	4.34	3.81	3.46	MNR
Lease-adjusted annual debt service burden (% of total revenue)	N.A.	4.3	4.3	5.1	6.6	MNR
Lease-adjusted annual debt service burden (% of total expenses)	N.A.	4.8	4.8	5.8	7.6	MNR

KIPP Nashville, Tennessee Select Enterprise And Financial Statistics (cont.)

	--Fiscal year-end June 30--					Medians for 'BBB-' rated charter schools
	2019p	2018	2017	2016	2015	2017
Maximum annual debt service (MADS) ($000s)	N.A.	N.A.	2,291	918	918	1,465
Lease-adjusted MADS coverage (x)	N.A.	N.A.	1.31	2.86	2.19	1.40
Lease-adjusted MADS burden (% of total revenue)	N.A.	N.A.	14.1	6.9	10.4	13.1
Lease-adjusted MADS burden (% of total expenses)	N.A.	N.A.	15.9	7.8	11.9	MNR
Pro forma MADS ($000s)	N.A.	3,879	N.A.	N.A.	N.A.	MNR
Pro forma lease-adjusted MADS coverage (x)	N.A.	0.92	N.A.	N.A.	N.A.	MNR
Pro forma lease-adjusted MADS burden (% of total revenue)	N.A.	18.2	N.A.	N.A.	N.A.	MNR
Pro forma lease-adjusted MADS burden (% of total expenses)	N.A.	20.2	N.A.	N.A.	N.A.	MNR
Total revenue per student ($)	N.A.	13,396	12,571	12,740	13,644	MNR
Balance sheet metrics						
Days' cash on hand	N.A.	144.9	186.8	191.0	292.3	102.5
Total long-term debt ($000s)	N.A.	4,842	722	512	449	MNR
Unrestricted reserves to debt (%)	N.A.	151.9	982.2	1,167.4	1,324.1	17.0
Unrestricted net assets as % of expenses	N.A.	28.7	46.8	46.7	57.2	24.8
General fund balance ($000s)	N.A.	5,521	6,803	5,687	4,806	MNR
Debt to capitalization (%)	N.A.	47.3	8.3	8.3	9.3	87.0
Debt per student ($)	N.A.	2,997	457	461	670	15,066
Pro forma metrics						
Pro forma unrestricted reserves ($000s)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Pro forma days' cash on hand	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Pro forma long-term debt ($000s)	N.A.	25,242	722	512	449	MNR
Pro forma unrestricted reserves to debt (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Pro forma debt to capitalization (%)	N.A.	83.0	10.0	9.0	10.0	MNR
Pro forma debt per student ($)	N.A.	15,865	560	488	693	MNR

p--Projected. N.A.--Not available. MNR--Median not reported. Operating lease expense--Annual amount paid in facilities/capital lease payments; excludes equipment/nonfacility lease payments and 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).