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Public Preparatory Charter Schools Academies, New York; Charter Schools

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Table Of Contents

Public Preparatory Charter Schools Academies, New York; Charter Schools

Credit Profile		
Public Preparatory Charter Schools Academies ICR		
Long Term Rating	BB+/Stable	Rating Assigned

Rating Action

S&P Global Ratings assigned its 'BB+' issuer credit rating (ICR) to Public Preparatory Charter School Academies (Public Prep, PPA, or the network), a New York not-for-profit education corporation, on behalf of Boys Preparatory Charter School of New York (Boys Prep Bronx, BPB, or Boys Prep). The outlook is stable.

An ICR reflects an 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, standing in bankruptcy or liquidation, statutory preferences, or legality and enforceability.

Public Prep was effective as a consolidated entity on October 1, 2014, following the merger of two schools. The network's first school opened in 2005. It currently operates five school campuses in New York City, with another elementary school scheduled to open in fall 2020 (approved by the authorizer). Schools are separately chartered and overseen by the State University of New York's (SUNY) Charter Schools Institute, the state's biggest charter authorizer and the nation's largest university-based charter school authorizer. There are four charter contracts, with elementary and middle schools for the same school each falling under one charter. Total network enrollment in fall 2019 was near 2,000, a massive more than 2,000% growth since the first school opening. All schools are pre-K through eighth grades.

We assessed the network's enterprise profile as adequate, with seasoned management, solid demand, a robust wait list, growing enrollment, and sound academic performance, tempered by continued expansion plans. We assessed the network's financial profile as adequate, with moderate debt levels, a manageable debt burden, respectable lease-adjusted maximum annual debt service (MADS) coverage, and Boys Prep's qualification for generous New York City charter facilities rental assistance under a state statute enacted in 2014. These rental assistance amounts benefit about one-third of New York City charter schools and exceed lease-adjusted MADS payments for network pro forma debt, which we consider a key credit strength. In our analysis, we conservatively factor in the full debt amount and lease payments, although this is expected to be fully offset by rental assistance funds. While there is potential for per-pupil funding cuts and corresponding lower rental assistance funds, we expect no meaningful changes to the network's financial metrics as currently assessed. We believe that, combined, these credit factors lead to an anchor for PPA of 'bbb-'. The 'BB+' ICR is based on our group credit profile on PPA and our view that the obligated group is "Highly Strategic" to the organization, as under our group rating methodology (GRM) criteria, published July 1, 2019. Given the obligated group's status as "Highly Strategic," the ICR is one notch below that on the group credit profile.

Boys Prep Bronx (one of the network schools) opened in 2014 and intends to enter into a maximum $7.5 million loan from the Equitable Facilities Fund to refinance two building improvement loans related to the Boys Prep Bronx leased facility (approximately $5.9 million outstanding as of June 30, 2019). This refinancing is intended to achieve material annual debt service savings and create a fairly level debt payment schedule. Boys Prep Bronx is the sole obligated group member, with loan repayment from its revenues. The loan security includes a first leasehold mortgage on the school facility and a first lien on Boys Prep Bronx's revenue. Based on our GRM criteria, our rating analysis encompasses the entire PPA organization, given the network's single board that oversees operations, dictates strategy, and ultimately controls the cash flows of its associated schools. We view the obligated group as important to the organization, with parent support of the obligated group likely in the event of operating difficulties. Specifically, our "Highly Strategic" group assessment for Boys Prep is based on its role and importance to PPA. The obligated group represents approximately 33% of total network fall 2019 enrollment, and 22% and 30% of total consolidated group assets and revenues, respectively, in fiscal 2019, which limits our view of the group status to "Highly Strategic." The ICR applies only to Boys Prep, which represents the obligated group, and not to PPA as an organization. Financial metrics cited in this report reflect those of the entire PPA organization, unless otherwise specified.

We understand that given the COVID-19 outbreak and broader public safety concerns, the governor of New York announced a closure of schools in the state for the remainder of the 2019-2020 school year. All PPA schools transitioned to a remote learning curriculum starting the week of March 19, 2020, utilizing an app-based program along with textbook- and project-based learning. We understand the network has so far successfully absorbed costs associated with the online transition and COVID-19-related costs with no meaningful impacts on enrollment, student retention, and finances. Despite uncertainty regarding the duration and extent of the impact from the COVID-19 outbreak and related effects on our rated entities' performance, including the ability to resume classes and absorb unreimbursed additional costs, fiscal 2020 per-pupil funding in New York continued at previously finalized levels on a timely basis. The state's fiscal 2021 budget, released on April 2, 2020 (the state has a March 31 fiscal year-end), resulted in flat per-pupil funding relative to fiscal 2020. However, given the extent of the state's anticipated fiscal 2021 budget shortfall (net $13.3 billion, per estimates) and mounting pressures on state finances as a result of the COVID-19-induced recession, we recognize state kindergarten to grade 12 (K-12) public funding could be meaningfully cut, although the full magnitude of cuts is not yet certain. Projected state revenue losses for charter schools could partly be offset by federal stimulus funds under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, and some expense savings (utilities, travel, etc.) associated with facility closures. In our view, the full financial impact of COVID-19 cannot be quantified at this time, but we believe fiscal 2021 financial performance could be more severely affected, depending on the trajectory of the virus and its impact on operations. Management is projecting a surplus for fiscal 2020, per its June 2020 internal forecast.

PPA management reports management is stress-testing for various scenarios and has budgeted a 5% contingency line. In our opinion, while PPA has weak liquidity at approximately 66 days' cash on hand projected as of June 30, 2020 (ignoring $4.3 million of paycheck protection plan [PPP] funds recently received; inclusion of these funds would result in a higher approximately 105 days' cash), management is focused on improving liquidity and reducing its receivables balance, with access to a recently secured $4.3 million PPP loan and a $1.5 million non-revolving line of credit with a bank (no funds currently drawn on it) that could partly absorb potential state funding cuts. Including PPP loan funds, projected unrestricted days' cash on hand is expected to be approximately 100 as of June 30, 2020. We will continue to monitor any developments in state funding or any potential impacts of recessionary pressures and take actions as we deem appropriate, particularly if network financials materially weaken from current assessment levels.

Established by the United States Small Business Administration under the recently passed CARES Act, the PPP provides liquidity to financial institutions which in turn provide loans that support small businesses in meeting payroll, debt service, rent, utilities, or health care-related expenses. An additional benefit is that PPP loans are eligible for forgiveness (all or in part) by the lender. In our in our view, this could provide additional operating cash flow support to the school in the near term to cushion against the impact of state funding cuts. We have not included this loan in our debt-based metrics, as it is uncertain if the loan will need to be repaid.

Credit overview

Specifically, the 'BB+' rating reflects our opinion of the network's:

- Increasing enrollment, currently exceeding 2000 students and supported by robust demand and a wait list exceeding 100% of headcount for fall 2019, with continued growth projected for fall 2020 based on year-to-date enrollment statistics;
- General rental assistance granted by state statute for 100% of Boys Prep current and future students which exceeds lease-adjusted MADS, and moderate pro forma leverage;
- Decent 1.55x lease-adjusted MADS coverage in fiscal 2019 (ignores the aforementioned rental assistance), with an expectation of a similar result for fiscal 2020; and
- Seasoned and skilled management, and a highly connected board with diverse skills.

Partly offsetting the above strengths, in our view, are the network's:

- Weak liquidity, with approximately 60 days' cash on hand projected at June 30, 2020 (ignoring PPP loan funds), and historically minimal levels resulting from internal reserve spenddowns associated with expansion and a large receivables balance, which management has worked to remedy;
- Moderate expansion plans, which inherently present some uncertainty and risk; and
- Risk, as with all charter schools, that the charter authorizer could close schools for nonperformance of charter contracts or financial distress.

The network draws the majority of its students from Bronx Community Districts 7 and 8. All charter contracts have received at least one charter renewal for the maximum possible five years; the earliest charter contract expires July 31, 2022. The network's good academic performance, niche, and sound regional reputation continue to draw students. Its niche as the nation's first non-profit network that exclusively develops single-sex K-8 schools and its focus on educating students to successfully complete college differentiates it from peers. The network is targeting growing enrollment to approximately 2,600 by 2025, which equates to an average annual 5% growth rate. With COVID-19, we are uncertain if enrollment and retention will suffer for our rated charter schools. This enrollment projection includes the opening of the new K-4 school in fall 2020 with an estimated 520 students at full enrollment in 2025.

The stable outlook reflects S&P Global Ratings' opinion that over the outlook period, we expect the network to maintain financial metrics around current assessment levels despite any state funding cuts, preserve its stable market position, good academics, and improve unrestricted days' cash on hand to levels more commensurate with the rating. We could reassess the rating if the obligated group's status evolves as a result of the network's expansion.

Environmental, social, and governance factors

In our view, the network is exposed to elevated health and safety social risk, given the recession's impact on state funding and the network's heavy dependence on state revenues to support operations. Despite the elevated social risk, we believe the network's environmental and governance risk are in line with our view of the sector as a whole.

Outlook

Downside scenario

We could consider a negative rating action if there is a failure to improve unrestricted days' cash on hand from the approximately 60 days' projected by management for fiscal 2020, if state funding and rental assistance is materially reduced from current levels, and if lease-adjusted MADS coverage declines to levels we no longer consider consistent with the current rating. Sharp enrollment decreases is likely to cause rating pressure. Although we think the network has taken steps to address COVID-19 and understand the virus to be a global risk, we could consider a negative rating action during the outlook period should unforeseen pressures related to the pandemic materially affect the network's demand, finances, or trajectory.

Upside scenario

We consider a positive rating action within our outlook period unlikely, given the current economic climate. We believe that financial and operational pressures caused by COVID-19, and the recession we are in, with the potential for steep state funding cuts constrain a positive rating action at this time. Beyond our outlook period, we could consider a positive rating action if the network were to meaningfully improve unrestricted days' cash on hand and lease-adjusted MADS coverage to levels more consistent with a higher rating category, while maintaining its enrollment, demand, and impressive academic performance.

Credit Opinion

Enterprise Profile

Economic fundamentals

The network draws approximately 50% of its students from Bronx County. The county's minor population size is robust, at about 5.11 million, with a projected modest decrease of 3% 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, 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 the network's enrollment and demand profile as sound, supported by significant enrollment increases in conjunction with a robust wait list. Total enrollment has grown by 29% since fall 2016 with the addition of new grades at existing schools. The network plans to add a new K-4 school in fall 2020, also in the Bronx, and has received authorizer approval for the same. The network's increase in enrollment amid maintenance of a wait list of 141.7% fall 2019 enrollment reflects excellent demand, in our opinion. The wait list, which PPA purges weekly, is particularly solid for the lower and middle school entry grades, but is what we consider healthy at every grade level. Student retention rates have been sufficient, in our view, measuring 82% in fall 2019. We expect network schools to maintain a healthy demand profile. The network faces competition from a number of nearby local public, private, and charter schools with varied grade offerings. Management reports that it is not aware of any new schools opening in its service area. There are no available charters left for new charter schools in New York City under the state cap on charter schools.

Boys Prep's enrollment increased by double-digits and more than trebled to 683 in fall 2019, from 202 in fall 2015. Its wait list was 176.9% of fall 2019 enrollment, which we consider impressive. Student retention was an average 82% in fiscal 2019. At full expansion into its full grades, Boys Prep projects it will have 885 students, 805 in K-8, and 80 in pre-K. For fall 2020, we understand to date PPA is enrolled at 101% of its budgeted enrollment with a total waitlist of 1,702 students. Boys Prep is enrolled 106% to budget with a total waitlist of 653 students, which we consider healthy.

We believe the network has an above-average academic profile. Test scores are substantially above those of its district peers. The 2018-2019 New York State exam scores showed the network was 62% proficient in English language arts, compared with 57% for all city charters, 47% for the city, and 45% for the state. PPA was also 61% proficient in math, compared with 63% for all city charters school district, 46% for the city, and 47% for the state. We understand the entire network--and Boys Prep specifically--have a history of impressive academic results that well exceed district averages.

We view the network's standing with the charter authorizer, SUNY Charter Schools Institute, as very good. SUNY provides financial and academic oversight, which is typical for its role as a state charter authorizer. Based on our discussion with the authorizer, they report a good working relationship with PPA and do not report any concerns with governance, academics, compliance, and finances. They noted potential state funding cuts are a concern for state charter schools. The statutory framework assessment reflects our opinion that despite areas of risk, the framework is not likely to hamper the network's future ability to pay debt service, unless state funding is materially impaired and weakens financial metrics.

The network's primary revenue source is per-pupil revenue from New York State, passed through to the school from New York City, the sending school district for all network students. Basic per-pupil funding has increased by 5.5% in fiscal 2020, to $16,150 from $15,308 in fiscal 2019. For fiscal 2021, management expects flat per-pupil state funding. We expect the network to maintain positive operations and we will continue to monitor any potential impact on the state funding environment.

Management and governance

PPA is governed by a seven-member independent board of trustees. The board size can be increased up to 10 members, per management. We believe the board is sufficiently independent from management.

Public Preparatory Network (PPN) Inc., a related not-for-profit organization, provides management and other administrative support services to the network. PPN is separately governed by an eight-member board, with overlap of two members with PPA's board. PPN maintains separate audited financials from PPA and we have not consolidated its financials into our assessment of PPA financials. PPA operates under a charter management organization agreement with PPN dated September 30, 2014, and revised December 2019, under which it pays a 15% annual service fee of the year-end student enrollment full-time equivalents multiplied by the approved per-pupil general education operating expenses for the school year, plus 15% annual service fee of special education funding. We understand the agreement can be terminated by PPA for cause and the annual service fee is typical for peer charter school networks in New York. The PPA board consists of individuals with backgrounds in finance, law, and education, among other areas, and an attempt is being made to diversify the board's expertise. Overall, we view the board as sufficiently diverse in skill sets and capable of managing a school network of this size. The board appears to have healthy community relationships and networks. We do not view the absence of formal board rotations as a substantially negative governance factor, as board members have rotated out as the organization has evolved. The board sets policy and strategy for the network, and monitors and oversees the performance of all constituent network schools.

Senior management is competent, skilled, and sophisticated. The network CEO departed the organization on June 30, 2020, to pursue an external opportunity after a decade in this role. The management team has put in place what we consider a reasonable transition plan. The CEO's replacement has been with the organization since 2016, with 15 years of experience in various capacities around education. In our view, the transition in this CEO role appears to have been carefully thought through, with the incoming CEO being quite familiar with the organization and its mission. This, in our view, should lend continued stability to operations, particularly given current uncertainties. Moreover, in our view, key person risk associated with having a long-serving CEO who oversaw the organization's exceptional growth in the past decade is partly mitigated with the hiring of new chief operating officer and the presence of key finance staff.

Financial performance

The network's financial performance can be characterized by positive, albeit variable, full-accrual operating margins with sufficient 1.55x pro forma lease-adjusted MADS coverage. In fiscal 2019, revenue was about $40.5 million and expenses were $39.8 million, resulting in a surplus of $752,000, or a 1.9% margin. Fiscal years 2018 and 2017 resulted in surpluses of $555,000 (1.7% margin) and $3.4 million (10.7%) respectively. The substantially larger fiscal 2017 surplus was the result of receipt of nonrecurring grants, which we have accounted for in our analysis. The positive, albeit inconsistent operating performance can be credited to excellent enrollment growth and increases in state per-pupil funding. The obligated schools do not have a separate audit, but operations are combined in the network's audit. Management anticipates achieving another sound full-accrual surplus for fiscal 2020 and thus maintaining its acceptable lease-adjusted MADS coverage around current assessment levels for the credit rating. However, given the expectation of state funding cuts in the near term, if lease-adjusted MADS coverage materially weakens from current assessment levels, it is likely to be viewed unfavorably. In fiscal 2020, the network is forecasting a $2.4 million surplus (6% margin), above its budgeted 4% margin for the fiscal year. The fiscal 2020 projection partially accounts for expenses related to COVID-19 (full effects are unknown) and state per-pupil funds were uninterrupted for this fiscal year. We believe the network will continue to post at least break-even operating margins over the outlook period. Additional material COVID-19-related expenses and potential for per-pupil funding cuts are likely to affect growth of this metric over the outlook period. Fiscal 2021 budgets have not yet been finalized, given the uncertainty around state funds.

Boys Prep's financial results resulted in a $776,000 surplus (6.2% margin) and a $217,000 deficit (negative 3.4% margin) in fiscal years 2019 and 2018. It projects a healthy $1.2 million surplus (approximate 8% surplus) for fiscal 2020. The pro forma lease-adjusted MADS coverage is a relatively slim 1.13x, based on fiscal 2019 results. Both PPA and Boys Prep's lease-adjusted MADS are fully offset by rental assistance and no operating dollars are being spent on lease payments or debt service.

Liquidity and financial flexibility

We consider the network's balance sheet a key credit weakness and a constraint on our current rating. Management has focused on improving unrestricted cash by reducing large accounts receivables and realizing savings from tighter expense controls and savings related to school facility closures as a result of the current pandemic. Management projects approximately $7 million in unrestricted cash as of June 30, 2020, ignoring PPP loan funds, equating to about 60 days' cash on hand. This is meaningfully improved from a minimal 14 days' cash on hand as of June 30, 2019, and 32 days' cash on hand at June 30, 2018. The drop in cash between fiscal years 2018 and 2019 was the result of a planned spenddown of internal funds for the Boys Prep facility (construction was completed in late 2018). Despite looming state funding cuts, we expect the organization's liquidity will remain above 60 days' or better over our outlook period.

Boys Prep's unrestricted days' cash on hand was approximately 23 and 28 days' on hand as of June 30, 2019, and June 30, 2018, respectively, with expectations for incremental improvements as enrollment increases.

Debt burden

The network's pro forma lease-adjusted MADS burden is what we consider manageable, at 7.3% of fiscal 2019 total revenues. PPA has minimal long-term debt and its pro forma debt per student is approximately 3,500 per student based on fall 2019 enrollment, as it has been successful in being co-located with NYC Department of Education (NYC DOE) public schools under city law. As a strategy, the network is pivoting to securing rental assistance to cover any lease payments associated with its planned expansion. The organization's pro forma debt-to-capitalization ratio is relatively low at 48.5%, given its small debt load. Management has no plans for additional new debt beyond targeting securing rental assistance for its new Girls Prep Bronx II facility. We believe the organization has some additional debt capacity at the current rating level, provided its operating trends, lease-adjusted MADS coverage levels, and unrestricted reserves remain steady.

In contrast, Boys Prep's pro forma lease-adjusted MADS burden, debt-to-capitalization, and debt per student (using fall 2019 enrollment) is weaker at 23.5%, 72.1%, and approximately $10,981, respectively.

Financial policies

The network meets standard annual disclosure requirements. Its audits are timely and sufficiently transparent, with no material or significant deficiencies in auditor findings. While no formal policies exist, it is targeting a 4% of surplus funds as reserves, and 60 days' cash on hand. No investment policy exists, typical for its charter peers, but the network has no aggressive investments. The financial policies assessment reflects our opinion that, while there may be some areas of risk, the network'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 network's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure, and a comparison of these policies with similar providers.

Public Preparatory Charter School Academies--Enterprise And Financial Statistics

	--Fiscal year ended June 30--				Medians for 'BBB-' rated charter schools
	2020	2019	2018	2017	2018
Enrollment					
Total headcount	2,099	1,971	1,723	1,624	1,098
Total waiting list	2,974	2,349	N.A.	N.A.	MNR
Waiting list as % of enrollment	141.7	119.2	N.A.	N.A.	35.3
Financial performance					
Accounting standard	FASB	FASB	FASB	FASB	N.A.
Total revenues ($000s)	N.A.	40,532	32,711	31,622	10,832
Total expenses ($000s)	N.A.	39,780	32,156	28,240	MNR
EBIDA ($000s)	N.A.	1,939	1,262	4,111	MNR
EBIDA margin (%)	N.A.	4.8	3.9	13.0	15.8
Excess revenues over expenses ($000s)	N.A.	752	555	3,382	MNR
Excess income margin (%)	N.A.	1.9	1.7	10.7	5.4
Operating lease expense ($000)	N.A.	2,629	0	0	MNR
Pension/OPEB adjustments ($000)	N.A.	N.A.	N.A.	N.A.	MNR
Lease-adjusted annual debt service ($000)	N.A.	2,916	N.A.	N.A.	MNR
Lease-adjusted annual debt service coverage (x)	N.A.	1.57	N.A.	N.A.	MNR
Lease-adjusted annual debt service burden (% total revenues)	N.A.	7.2	N.A.	N.A.	MNR
Lease-adjusted MADS ($000s)	N.A.	N.A.	N.A.	N.A.	1,244
Lease-adjusted MADS coverage (x)	N.A.	N.A.	N.A.	N.A.	1.60
Lease-adjusted MADS burden (% total revenues)	N.A.	N.A.	N.A.	N.A.	11.1
Pro forma MADS ($000s)	N.A.	2,953	2,953	2,953	MNR
Pro forma lease-adjusted MADS coverage (x)	N.A.	1.55	0.43	1.39	MNR
Pro forma lease-adjusted MADS burden (% total revenues)	N.A.	7.3	9.0	9.3	MNR
Total revenue per student ($)	N.A.	20,564.2	18,984.9	19,471.7	MNR
Balance sheet metrics					
Unrestricted reserves ($000s)	N.A.	1,520.0	2,788.0	2,497.0	MNR
Days' cash on hand	N.A.	14.3	32.4	33.1	146.80
Total long-term debt ($000s)	N.A.	5,579	N.A.	N.A.	MNR
Unrestricted reserves to debt (%)	N.A.	27.2	N.A.	N.A.	25.9
Unrestricted net assets as % of expenses	N.A.	20.6	22.7	25.5	31.7
Debt to capitalization (%)	N.A.	41.2	N.A.	N.A.	84
Debt per student ($)	N.A.	2,831	N.A.	N.A.	13,975

Public Preparatory Charter School Academies--Enterprise And Financial Statistics (cont.)

	--Fiscal year ended June 30--				Medians for 'BBB-' rated charter schools
	2020	**2019**	**2018**	**2017**	**2018**
Pro forma metrics					
Pro forma unrestricted reserves ($000s)	N.A.	1,520	2,788	2,497	MNR
Pro forma days' cash on hand	N.A.	14.3	32.4	33.1	MNR
Pro forma long-term debt ($000s)	N.A.	7,500	N.A.	N.A.	MNR
Pro forma unrestricted reserves to debt (%)	N.A.	20.3	N.A.	N.A.	MNR
Pro forma debt to capitalization (%)	N.A.	48.5	N.A.	N.A.	MNR
Pro forma debt per student ($)	N.A.	3,805	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 related to principal and interest on bonds. Net revenue available for debt service = EBIDA + operating lease expense. Lease-adjusted MADS coverage = (net revenue available for debt service + operating lease expense) / (lease-adjusted MADS). Total expenses include pension and OPEB adjustments. Pension and OPEB adjustments = reconciling adjustments made to financial information to account for differences in GASB 68 and GASB 75.

Related Research

- U.S. Public Finance Charter Schools: Methodology And Assumptions, Jan. 3, 2017
- Criteria Guidance: U.S. Public Finance Charter Schools, Dec. 20, 2019
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020