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KIPP Nashville, Tennessee; Charter Schools

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KIPP Nashville ICR		
Long Term Rating	BBB-/Stable	Affirmed

Rating Action

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

An ICR reflects our view of 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 obligations' nature and provision, bankruptcy standing, or liquidation, statutory preference, or legality and enforceability. Pro forma for an anticipated loan, KIPP Nashville will have total debt outstanding of $41.9 million, which includes Equitable School Revolving Fund loans of $29.5 million as well as other debt. Pro forma for the 2020 EFF loan, the school's debt will be secured under a Master Trust Indenture (MTI) that was established in 2019, which includes a parity pledge of and lien on revenues and a first-priority deed of trust on all existing real property owned by the borrower, and any property as may be secured by the MTI in the future. Management plans to use net proceeds from additional debt to finance construction of a new middle school facility on KIPP's existing Antioch campus, and to refinance a loan from LIIF used to finance the KIPP Antioch elementary school.

Given the COVID-19 pandemic and broader public safety concerns, the Tennessee governor recently ordered all Tennessee schools to close. KIPP Nashville has moved to remote learning platforms for students, which it is rolling out in phases. The school plans to provide laptops to students in need, guaranteeing access to the new online curriculum. We also understand that the Tennessee Department of Education has advised that state testing won't be required for this year. Despite high uncertainty regarding the duration and extent of the disruption from the COVID-19 outbreak and the related effects on the performance of our rated entities, including the ability to resume classes, and its effect on enrollment and state funding, the current expectation is that state per-pupil funding will continue for the fiscal year, which ends June 30, 2020. Tennessee's legislature recently passed an emergency budget reflecting significantly reduced spending in reaction to COVID-19, however, the budget maintained its $40 million education voucher program. The legislature does not currently plan to meet again until June 1, 2020. While state funding has improved in recent years and legislation has been supportive of charter schools, we believe state funding in fiscal 2021 could be cut given current economic conditions--we will continue to monitor developments for any potential credit effects and we will take action as we deem appropriate. In our opinion, KIPP Nashville has good liquidity at the current rating level to withstand moderate funding cuts and has a history of budgeting conservatively. Management is planning for a potential cut in state funding as it budgets for fiscal 2021.

Credit overview

We assessed KIPP Nashville's enterprise profile as adequate with solid demand, characterized by its strong enrollment growth, decent student retention, and above-average academic performance, offset by a modest waitlist. We assessed

KIPP Nashville's financial profile as adequate, characterized by its solid pro forma lease-adjusted maximum annual debt service (MADS) coverage 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-'.

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 surplus operations for fiscal 2020;
- Healthy pro forma lease-adjusted MADS coverage of 2.07x based on audited fiscal 2019 results; and
- Good cash for the rating, with 231 days' cash on hand for fiscal 2019 (inclusive of loan proceeds), and expectations for 156 days' cash on hand at fiscal year end 2020, with similar amounts projected for fiscal year end 2021.

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

- Rapid expansion plans, which inherently present some uncertainty;
- High leverage 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.

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.

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 six additional schools, inclusive of a school that recently opened 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, for which the charter applications have already been submitted. It serves 2,319 K-12 students as of fall 2019. The charter school has acquired two campuses, encompassing four schools. The remaining three existing schools operate out of leased facilities. KIPP originally financed the owned campuses through privately placed bonds held by Pinnacle Bank.

Environmental, social, and governance factors

We analyzed KIPP Nashville's environmental, social, and governance risks relative to its market position, management and governance, financial resources, and debt and liability profile and determined that all are in line with our view of the sector standard.

Stable Two-Year Outlook

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 deteriorates, cash declines, and lease-adjusted MADS weakens. In addition, if KIPP Nashville issues additional debt that materially impairs the school's financial operations and debt, we could lower the rating or revise the outlook to negative. Although we think KIPP Nashville has taken proactive steps to address COVID-19, and we understand the virus is a global risk, we could consider a negative rating action during the outlook period should unforeseen pressures related to the pandemic materially affect demand, finances, or the trajectory of the school.

Upside scenario

Although unlikely to occur during the two-year outlook period due to the current economic environment, as well as the school's expansion and additional debt plans, we could raise the rating or revise the outlook to positive outside of the outlook period if the school strengthens its financial profile and maintains healthy full-accrual operating surpluses such that lease-adjusted MADS coverage improves significantly while demonstrating growing enrollment and further strengthening its enterprise profile to levels that we consider commensurate with those of a higher rating.

Credit Opinion

Enterprise Profile

Economic fundamentals

KIPP Nashville is in Davidson County, which is the state's second-most populous county. Its minor population is about 230,000. The projected five-year, school-age population growth rate is 2.7% through 2025.

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 nearly 14% in fall 2019 from fall 2018; enrollment has doubled during the past five 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 and in July 2019, it opened KIPP Antioch College Preparatory Middle School.

Management expects to add three new schools (an elementary, middle, and high school) in southern-eastern Nashville during the next few years, completing cluster two.

In total, KIPP Nashville expects to operate 10 schools by the 2023-2024 school year, with an eventual estimated enrollment of at least 4,500 students Enrollment is currently 2,319 for all seven existing schools, with expectations to be near 2,700 in fall 2020. The schools' total waitlist was 377 in fall 2019, which represents about 16.3% of total enrollment, however, this number 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 2019. 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 14-consecutive years; in 2015, the authorizer recently renewed the charter for 10 years to 2025. 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 Antioch-campus schools in the second cluster. 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, which has increased about 3.5% during the past three years, which we view favorably. The impacts from slower economic growth could vary greatly by state, but for some, it could mean material reductions in state funding. If there are any changes in state funding that materially affect financial performance, we could revisit our view of the rating.

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 $16.6 million during the past five fiscal years (2015-2019) 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. However, the current recessionary environment could pressure fundraising capabilities. 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 increasing per-pupil funding. For fiscal 2019, KIPP Nashville posted an EBIDA margin of 22% of operating revenue and an operating surplus of $5 million, or a 17.7% operating margin, a level that we view as strong for the rating.

Pro forma lease-adjusted MADS of about $3.337 million includes all debt service outstanding and associated with existing campuses. Pro forma lease-adjusted MADS coverage on KIPP Nashville's debt is good for the rating, in our view, at 2.07x based on fiscal 2019 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. Pro forma lease-adjusted MADS burden is modest, in our view, at about 11.8% of operating revenue for fiscal 2019. The fiscal 2020 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, 2019, KIPP Nashville had $14.2 million of unrestricted cash and investments, or 231 days' cash on hand, which we view as solid. However, days' cash on hand is expected to be lower at 156 days' at fiscal year-end 2020 due primarily to growing expenditures related to new schools. 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 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 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 is $41.9 million. KIPP Nashville's current growth-and-expansion plan calls for additional debt issuance between fiscal years 2021-2023. However, we understand any additional parity debt will likely have to meet 1.2x debt service coverage (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 pro forma ratio was 39%. We view the school's debt as a constraining rating factor.

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.

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, Tenn.--Enterprise And Financial Statistics

	--Fiscal year ended June 30--					--Medians reported for 'BBB-' rated charter schools--
	2020	**2019**	**2018**	**2017**	**2016**	**2018**
Enrollment						
Total headcount	2,319	2,038	1,591	1,290	1,050	1,098
Total waiting list	377	305	321	262	226	MNR
Waiting list as % of enrollment	16.3	15.0	20.2	17.0	21.5	35.3
Financial performance						
Accounting standard	N.A.	GASB	GASB	GASB	GASB	N.A.
Total revenues ($000s)	N.A.	28,318	21,313	16,216	13,377	10,832
Total expenses ($000s)	N.A.	23,293	19,195	14,385	11,819	MNR
EBIDA ($000s)	N.A.	6,100	2,891	2,353	1,963	MNR
EBIDA margin (%)	N.A.	21.5	13.6	14.5	14.7	15.8
Excess revenues over expenses ($000s)	N.A.	5,025	2,118	1,831	1,558	MNR
Excess income margin (%)	N.A.	17.7	9.9	11.3	11.6	5.4
Operating lease expense	N.A.	806	679	648	659	MNR
Pension/OPEB adjustments ($)	N.A.	115	181	(253)	(420)	MNR
Lease adjusted annual debt service ($)	N.A.	1626*	918	692	688	MNR
Lease-adjusted annual debt service coverage (x)	N.A.	4.25	3.89	4.34	3.81	MNR
Lease-adjusted annual debt service burden (% total revenues)	N.A.	5.7	4.3	4.3	5.1	MNR
MADS ($000s) (change to Lease adjusted MADS)	N.A.	2,291	2,291	2,291	918	1,244
Lease-adjusted MADS coverage (x)	N.A.	3.01	1.56	1.31	2.86	1.60
Lease-adjusted MADS burden (% total revenues)	N.A.	8.1	10.7	14.1	6.9	11.1
Pro forma MADS ($000s)	N.A.	3,337	2,263	N.A.	N.A.	MNR
Pro forma lease-adjusted MADS coverage (x)	N.A.	2.07	1.58	N.A.	N.A.	MNR
Pro forma lease-adjusted MADS burden (% total revenues)	N.A.	11.8	10.6	N.A.	N.A.	MNR
Total revenue per student ($)	N.A.	13,895.0	13,396.0	10,502.6	12,740.0	MNR
Balance-sheet metrics						
Unrestricted reserves ($)	N.A.	14,245	7,355	7,101	5,977	MNR

KIPP Nashville, Tenn.--Enterprise And Financial Statistics (cont.)

	--Fiscal year ended June 30--					--Medians reported for 'BBB-' rated charter schools--
	2020	**2019**	**2018**	**2017**	**2016**	**2018**
Days' cash on hand	N.A.	230.62	144.90	186.75	191.00	146.80
Total long-term debt ($000s)	N.A.	21,407	4,842	722	512	MNR
Unrestricted reserves to debt (%)	N.A.	66.5	151.9	982.2	1,167.4	25.9
Unrestricted net assets as % of expenses	N.A.	55.0	28.7	46.8	46.7	31.7
Debt to capitalization (%)	N.A.	62.9	47.3	8.3	8.3	84
Debt per student ($)	N.A.	10,325	2,997	381	461	13,975
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 ($000s)	N.A.	41,907	25,242	722	512	MNR
Pro forma unrestricted reserves to debt (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Pro forma debt to capitalization (%)	N.A.	77	83	10	9	MNR
Pro forma debt per student ($)	N.A.	20,563	15,865	468	488	MNR

*$6.993 million principal payment less $6.5 million bullet-note payment. MADS--Maximum annual debt service. OPEB--Other postemployment benefits. 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 equals EBIDA plus operating lease expense. Lease-adjusted MADS coverage equals (net revenue available for debt service plus operating lease expense) / (lease-adjusted MADS). Total expenses include pension and OPEB adjustments. Pension and OPEB adjustments equals reconciling adjustments made to financial information to account for differences in Governmental Accounting Standards Board Statement Nos. 68 and 75. N.A.--Not available. MNR--Median not reported.