

RatingsDirect®

Great Oaks Legacy Charter School, New Jersey; Charter Schools

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Credit Profile

ICR

Long Term Rating

BB+/Stable

New

Rating Action

S&P Global Ratings assigned its 'BB+' issuer credit rating (ICR) to Great Oaks Legacy Charter School (Great Oaks), N.J. 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.

Great Oaks, via Little Acorn LLC, a single-purpose entity, intends to enter into a loan agreement of approximately \$14.3 million with the Equitable Facilities Fund (EFF) to provide financing for the construction of a new middle school facility, fund capitalized interest, refinance a \$1.5 million loan with Local Initiatives Support Coalition (LISC), and reimburse the organization for pre-construction costs already incurred. Based on current expectations, the EFF financing will be structured as a 30-year loan with level debt service payments and total proceeds of approximately \$17 million, including a \$2.7 million reoffering premium.

Great Oaks currently makes lease payments to support a New Markets Tax Credit (NMTC) that funded the construction of its high school facility. The financing, completed via the Great Oaks Newark Property Corp., includes The Reinvestment Fund as the senior lender and Civic Builders as the junior lender. The NMTC transaction is due to unwind in December 2022, at which time Great Oaks intends to refinance the non-forgivable portion of the loan of approximately \$6.1 million. The NMTC transaction does not appear on Great Oaks' books, though we are including the planned refinanced portion in our pro forma debt figures along with the EFF loan. The EFF loan is a general obligation of Great Oaks, secured by a first-lien pledge of rental payments and first-mortgage liens on all land and facilities owned by the school, with the exception of the high school facility, which is pledged to the NMTC transaction until it unwinds.

Following the COVID-19 outbreak, Great Oaks transitioned to online instruction, following two weeks of planning. Beyond virtual instruction, the school supported families and students by distributing meals and providing care packages. Great Oaks made additional investments over the summer to ensure that all families had access to Chromebooks or hotspots as necessary. After surveying families, Great Oaks began the school year on time via distance learning. In September and October, the school introduced "learning hubs"--opportunities for students to complete remote instruction in a safe, supervised setting. About 15% of families opted into the learning hub through November, when the school reverted to 100% remote through the end of the holidays. Following winter break, it

resumed the learning hub model with a goal of steadily increasing the number of students served, with a primary focus on those most at risk. The school continues to monitor relevant health and safety guidelines and adjust plans as necessary.

Despite uncertainty regarding the duration and extent of the effect of the COVID-19 pandemic, funding in New Jersey continued without delay for fiscal 2020, with flat per-pupil funding for fiscal 2021. Great Oaks has been allocated approximately \$1.25 million in Coronavirus Aid, Relief, and Economic Security (CARES) Act funding for COVID-19-related expenses, with the funds functioning as a grant to schools to offset pandemic-related costs. In addition, the state borrowed \$4.3 billion (with approval for up to \$9.9 billion) to provide emergency relief related to COVID-19 and to alleviate fiscal pressures for public-service entities, including education. We understand Great Oaks expects to receive an additional \$4.5 million from the recently passed Coronavirus Response and Relief Supplemental Appropriations Act and will monitor details on timing as they become available.

Credit overview

We assessed Great Oaks' enterprise profile as adequate, reflecting recent and expected enrollment growth, sufficient demand with good student retention, a history of successful charter renewals, and a proactive management team, which offset transition risk associated with continued growth plans. We assessed its financial profile as vulnerable, with below 1x pro forma maximum annual debt service (MADS) coverage, sufficient liquidity, and a moderately high, but manageable, debt burden. We believe that, combined, these credit factors lead to an anchor of 'bb'. As our criteria indicate, the final rating can be within one notch of the anchor rating level. In our opinion, the final 'BB+' rating on Great Oaks' bonds better reflect the organization's sound market position, successful track record of growth, and unrestricted reserves in line with the 'BB+' rating level.

The rating also reflects our view of Great Oaks':

- Growing enrollment and good demand, reflected by healthy student retention and rising applications recorded under the city's common enrollment platform;
- Sufficient unrestricted reserves with about 90 days' cash on hand as of fiscal 2020 year-end and steady liquidity expected for the near term;
- Healthy academic outcomes, supported by a unique tutor support model, enhancing the educational experience and draw for students; and
- History of successful charter renewals, with a recent renewal in February 2021 extending five years through June 2026.

Offsetting credit factors, in our view, include:

- Modest operating results with weak pro forma lease-adjusted MADS coverage for the rating level, though our calculation is somewhat conservative as it incorporates future lease expenses without the benefit of the additional revenues expected growth will provide;
- Potential plans for additional financing or lease needs over time given longer-term expansion discussions; and
- The inherent uncertainty associated with charter renewals, given that the final maturity on the bonds exceeds the length of the existing charter.

The stable outlook reflects our expectation that Great Oaks will build its operations to support sufficient MADS coverage, good liquidity, and a moderating debt burden, while successfully transitioning to its new facility and meeting enrollment growth projections over time.

Great Oaks began operations in the 2011-2012 school year with a commitment to serve Newark's under-resourced communities with a focus on a rigorous college-preparatory curriculum. It originally began serving grades 6-12, but expanded to serve grades pre-K-12, following a merger with Newark Legacy Charter School in July 2016. It currently operates two elementary schools, three middle schools, and one high school, with total enrollment of 1,897 in the 2020-2021 school year. Great Oaks plans to open its third elementary school in a leased facility in fall 2021. The school is authorized by the New Jersey Department of Education (NJDOE) with an enrollment cap of 3,037.

Great Oaks' educational model includes a high degree of personal support from teachers and staff, supplemented by a unique tutoring model, known as Tutor Corps, which provides each middle and high school student with two hours of tutor support daily. Tutors meet with the same student(s) each day and are highly involved with both Great Oaks staff and students' parents with regard to developing and implementing study plans and monitoring progress. Tutor Corps members are recent college graduates who commit to one year of service at Great Oaks and are compensated with an annual stipend and free housing that Great Oaks rents for members.

Great Oaks is affiliated with the broader Great Oaks Foundation, which also supports charter schools operating in New York City; Bridgeport, Conn.; Wilmington, Del.; and Baltimore. The foundation conducts recruiting for the Great Oaks' tutoring program through AmeriCorps for an annual fee stipulated under a contracted services agreement. The foundation provides modest fundraising support, but does not provide direct financial assistance, is not involved in management of the schools, nor is it obligated in any way on Great Oaks' debt.

Environmental, social, and governance factors

We view the risks posed by COVID-19 to public health and safety as an elevated social risk for all charter schools under our environmental, social, and governance (ESG) factors. We believe this is a social risk for Great Oaks because of its heavy dependence on state revenues to support operations and the potential for per-pupil funding reductions that may occur as a result of pressures stemming from the pandemic. Despite the elevated social risk, we believe the school's environmental and governance risk are in line with our view of the sector.

Stable Outlook

Downside scenario

We could consider a negative rating action should Great Oaks fail to meet its enrollment targets with sustained operating deficits, weakened MADS coverage, or a notable decline in liquidity from current levels. Though not currently planned, we would view any significant additional debt negatively. While management has taken steps to mitigate the effects of COVID-19, we could consider a negative rating action during the outlook period should unforeseen pressure materially affect the organization's demand, finances, or overall trajectory.

Upside scenario

We could consider a positive rating action should Great Oaks successfully execute its near-term expansion plans with improved lease-adjusted MADS coverage, continued growth in liquidity and moderating debt burden, with limited plans for additional debt over time.

Credit Opinion

Enterprise Profile

Economic fundamentals

Great Oaks draws about 85% of its students from Newark in Essex County. The county's minor population size is sizable at about 260,000, but is projected to decline by roughly 3% over the next five years.

Industry risk

Industry risk addresses the charter school sector's overall cyclical and competitive risk and growth by applying various stress scenarios and evaluating barriers to entry, 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 Great Oaks' enrollment and demand profile as sound, supported by consistent enrollment growth in recent years, solid and stable student retention, and good academics compared to local public schools. Since the 2016 merger, enrollment growth has averaged nearly 14% annually to 1,897 for the 2020-2021 school year. Growth in recent years reflects the addition of grades at several school locations. Great Oaks' current strategy is to increase enrollment to just over 2,600 by fall 2026 by adding one grade per year at the new elementary school and increased enrollment across existing schools over time, supported by the construction of the new middle school facility. In our view, these growth expectations are reasonable given Great Oaks' ability to historically meet or surpass enrollment targets and solid student retention.

Great Oaks participates in Newark Public School's (NPS) universal enrollment system (Newark Enrolls), which allows parents to complete a single application for both district and charter schools, with a ranking for their top eight schools. Given the ranking process and universal enrollment system, we understand from management that waiting lists in the traditional sense no longer exist for schools participating in Newark Enrolls. However, according to data provided, total applications for fall 2020 increased 14% over the prior year, to a total of 2,429, or 128% of current enrollment. Student retention has been good and has improved from 92% in fall 2016 to 94% for fall 2021. Great Oaks serves a high proportion of high-needs students with 87% of students qualifying for free or reduced lunch--higher on average compared to NPS.

Great Oaks' schools are currently housed in four buildings, all under leased arrangements. Legacy Elementary and Middle schools are in a leased NPS building through 2033; Downtown Middle School is in a newly constructed facility in Newark's teacher village and leased through 2032; and Downtown Elementary School is subleased from KIPP New

Jersey through 2027. As noted, the high school is leased under the NMTC transaction with a lease-to-buy option which Great Oaks intends to execute along with a refinancing of the NMTC obligation when it unwinds. The new elementary school, Fairmount Elementary, will be leased from a local non-profit under a long-term 20-year lease and Fairmount Middle School will transition to the newly constructed campus, once completed in fall 2022. Great Oaks' current and planned facilities can fully support the network's expected enrollment growth.

Based on historical testing outcomes, overall academic performance tends to outperform NPS, but lags state proficiency rates in both English language arts and math. However, when compared to the subgroup of economically disadvantaged students, Great Oaks outperforms both NPS and statewide proficiency rates, which has supported the school's healthy demand. In addition, there was notable improvement in 2019 test scores versus the prior year, which management attributes to improved scores of pre-merger Legacy students that started to benefit from several years of Great Oaks' academic approach and robust tutoring program. Overall performance has generally indicated improvement over time as students stay with Great Oaks and advance through the grades. Great Oaks' mission is to prepare every student for college success, with an impressive 100% high school graduation rate in 2020, with 79% of those students matriculating to college.

NJDOE provides academic and financial oversight as the school's charter authorizer. The department granted the school's initial charter in 2011 for an initial four-year term and has since renewed it three times--at the expiration of the initial charter term in 2015, the merger with Newark Legacy in 2016, and recently in February 2021 for a five-year term extending through June 2026. Based on our discussion with the authorizer, NJDOE reports a good working relationship with Great Oaks and did not note any notable concerns with governance, academics, compliance, and finances.

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 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. The statutory framework assessment reflects our opinion that, while there may be some areas of risk, the framework is not likely to impair Great Oaks' future ability to pay debt service, unless state funding is materially impaired and weakens financial metrics.

Management and governance

In our view, Great Oaks' senior leadership team is sophisticated, experienced, and highly capable, providing a solid foundation of oversight for the organization. We believe the school is led by a dynamic executive director and founder, with support provided by an active leadership team including experienced individuals in key roles. Great Oaks' long-tenured CFO is moving to a part-time capacity in his position, with his prior responsibilities split between a school business administrator and COO. There is a clear organizational structure that management has built out in recent years, with the addition of two chief academic officers, a chief corps officer, and a chief strategy officer, to support the network's expansion plan. We understand that there are also opportunities for professional development and discussions around succession planning, though no additional leadership changes are expected at this time.

Additional oversight is provided by an active eight-member independent board of trustees, and consists of individuals with diverse backgrounds in education, finance, medicine, law, engineering/construction management, and

communications. The board also represents individuals with a solid presence in the local community, which we believe provides stability for the network's demand and operations. We understand that the organization expects to engage in continued strategic planning efforts to guide near-term goals, which likely will include discussion around further expansion plans with potential plans to add one more elementary, middle, and high school each. These discussions are preliminary at this time based on our understanding and would require an increase in the charter cap to support this expected enrollment growth over time. In our view, management has been prudent in terms of prior growth and facilities planning, and we expect any future expansion would be handled similarly.

Financial Profile

We analyze the materiality, strategy, and funding of pension plans separately from our analysis of a school's long-term debt ratios or operating margin. Consequently, we may make certain adjustments to the calculations of debt ratios or operating margin for schools with substantial multiemployer, cost-sharing, defined-benefit pension plans to separate out the net pension liability or noncash expense accrual. In our view, these adjustments enhance analytical clarity from a credit perspective, resulting in more comparable debt and operating metrics across accounting methods.

State funding environment

In New Jersey, the state determines how much funding is appropriate to educate students in each school district, then examines each related local tax base to determine how much of the funding can be derived from the local tax levy and what portion the state must fund. In Newark, 85% currently comes from the state because of the weak local property tax base. Therefore, charter schools in low-income areas depend almost entirely on the state for operating revenue that is subject to annual appropriation by the state legislature. Charter and district schools receive funding through a student-weighted formula that takes into account the demographic factors of every student in the school. A base level of funding is provided for each student, along with additional amounts based on factors such as grade, income level, special needs, and language needs. Schools in Newark and other low-income communities also receive per-pupil "parity aid"--an amount equal to the average annual amount spent for each child by the state's wealthiest districts, which is protected by the state's School Funding Reform Act. Charter schools receive 90% of the per-pupil formula amount, with the remaining 10% assigned to the student's home district.

Overall, per-pupil funding has been flat for the last four fiscal years and remained flat for fiscal 2021. While the governor's budget for fiscal 2022 reflects flat per-pupil funding, there is longer-term uncertainty around possible cuts, given the state's budgetary pressures and slow economic recovery due to COVID-19. Management is preparing accordingly and budgeting conservatively, with sustained enrollment growth and careful expense monitoring expected to provide some cushion in the event of funding pressures.

Financial performance

Great Oaks has a history of modest operating surpluses in recent years, largely reflecting disciplined expense control, continued enrollment growth, and flat per-pupil funding. For fiscal 2020, we adjusted operating performance to remove the effects of the recognition of one-time revenue (\$1.4 million) associated with the LISC loan as well as one-time capital expenses (\$3.4 million). We understand these capital expenses have been one-time in nature to support Great Oaks' growth and facility projects, but are required to be recorded under the statement of activities by

NJDOE, as stated in the school's audit. Incorporating these adjustments, fiscal 2020 results were in line with those of the prior fiscal year. Fiscal 2020 operations support relatively weak coverage of pro forma lease-adjusted MADS at under 1x. However, we recognize this calculation is conservative, given that it incorporates future lease and debt service payments without the benefit of the additional revenues expected from enrollment growth.

Fiscal 2021 performance is expected to be healthier, based on conservative funding expectations going into the fiscal year, support from the CARES Act and other grants, and expense savings during virtual learning. In addition to CARES Act funding, Great Oaks was also approved for \$2.1 million in grants from the Charter School Growth Fund, which will be paid out in five equal installments through December 2024, with the first payment received this past December. The organization has also been successful in fundraising efforts to support its growth campaign that kicked off in fiscal 2020. It raised \$8 million in its first year relative to a goal of \$9.4 million. We expect Great Oaks will maintain positive performance in the near term, with an overall operational profile consistent with the rating level as the organization grows into its current financing plans. Though per-pupil funding could be pressured based on the state's budget situation over time, management has a history of budgeting conservatively and outperforming expectations, which speaks to operational flexibility, should it be needed.

Liquidity and financial flexibility

Great Oaks has historically maintained a good liquidity position for the rating level, though days' cash on hand dipped in fiscal 2019 to about 51 days' cash on hand due to a large receivable from NPS that came in shortly after the end of the fiscal year on July 5. Including this receivable, days' cash would have been at 94 days, consistent with historical and current results. Great Oaks' pro forma cash to debt metrics are good for the rating at just above 40% based fiscal 2020 performance. The organization's current unrestricted reserves, as well as the additional support from expected grants as described above, provides some cushion to weather uncertainty related to the pandemic and the potential for future funding cuts. Overall, we expect Great Oaks will maintain sufficient liquidity for the rating level.

Debt burden

Pro forma debt of roughly \$20.4 million consists of the EFF loan and expected refinancing of the NMTC transaction. Overall, the debt burden is manageable, in our view, relative to the network's size and operating trends. Based on fiscal 2020 revenues, the pro forma lease-adjusted MADS burden of \$4.2 million is somewhat elevated at 12.1%. Management reports no immediate debt plans or significant capital needs, and so we expected incremental improvement in debt metrics over time. We will continue to monitor the school's potential expansion plans and their potential effects on financial metrics once details are finalized.

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 for TPAF was 26.95% of the total pension liability, as defined in GASB Statement No. 67, and 42.04% for PERS as of June 30, 2019. Under current funding assumptions, TPAF is projected to be exhausted by 2036, and PERS by 2040. The state lowered its return assumption to 7.50% in 2017, from 7.65%, and is phasing in a reduction to 7.00% over the next four years, a change that, while

positive in that it lowers the system's reliance on investment returns, will also result in higher contributions for local government units. While the academy's pension and other postemployment benefit costs are limited to the minimal costs associated with its employees in PERS, we believe the state's continued pension-funding problems could create budgetary stress for Great Oaks, particularly if New Jersey moves away from fully supporting the TPAF cost.

Financial policies

Great Oaks meets standard annual disclosure requirements. Audits are timely and sufficiently transparent, with no material or significant deficiencies in auditor findings. The network maintains an internal target of days' cash on hand for operating purposes and informal approach to risk management, with insurance coverage for key areas. 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 impair 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 schools.

Great Oaks Legacy Charter School, NJ -- Enterprise And Financial Statistics					
	--Fiscal year ended --				
	2021	2020	2019	2018	2017
Enrollment					
Total headcount	1,897	1,675	1,531	1,538	1,159
Total waiting list	N.A.	N.A.	N.A.	N.A.	N.A.
Waiting list as % of enrollment	N.A.	N.A.	N.A.	N.A.	N.A.
Financial performance					
Accounting standard	N.A.	GASB	GASB	GASB	GASB
Total revenues (\$000s)	N.A.	35,187	32,534	27,003	24,547
Total expenses (\$000s)	N.A.	34,194	31,606	26,766	19,721
EBIDA (\$000s)	N.A.	1,539	1,560	689	5,190
EBIDA margin (%)	N.A.	4.4	4.8	2.6	21.1
Excess revenues over expenses (\$000s)	N.A.	993	928	237	4,826
Excess income margin (%)	N.A.	2.8	2.9	0.9	19.7
Operating lease expense (\$000)	N.A.	2,287	1,994	1,756	1,147
Pension/OPEB adjustments (\$000)	N.A.	0	(2,214)	(445)	(441)
Lease adjusted annual debt service (\$000)	N.A.	2,287	1,994	1,756	1,147
Lease-adjusted annual debt service coverage (x)	N.A.	1.67	1.78	1.39	5.52
Lease-adjusted annual debt service burden (% total revenues)	N.A.	6.5	6.1	6.5	4.7
Lease-adjusted MADS (\$000s)	N.A.	2,401	2,401	2,401	2,401
Lease-adjusted MADS coverage (x)	N.A.	1.59	1.48	1.02	2.64
Lease-adjusted MADS burden (% total revenues)	N.A.	6.8	7.4	8.9	9.8
Pro forma lease-adjusted MADS (\$000s)	N.A.	4,265	N.A.	N.A.	N.A.
Pro forma lease-adjusted MADS coverage (x)	N.A.	0.90	N.A.	N.A.	N.A.
Pro forma lease-adjusted MADS burden (% total revenues)	N.A.	12.1	N.A.	N.A.	N.A.

Great Oaks Legacy Charter School, NJ -- Enterprise And Financial Statistics (cont.)

	--Fiscal year ended --				
	2021	2020	2019	2018	2017
Total revenue per student (\$)	N.A.	21,007	21,250	17,557	21,180
Balance sheet metrics					
Unrestricted reserves (\$000s)	N.A.	8,204.0	4,300.0	8,104.0	6,646.0
Days' cash on hand	N.A.	89.0	50.7	112.4	125.3
Total long-term debt (\$000s)	N.A.	1,383	N.A.	N.A.	N.A.
Unrestricted reserves to debt (%)	N.A.	593.2	N.A.	N.A.	N.A.
Unrestricted net assets as % of expenses	N.A.	24.7	28.6	35.1	47.6
Debt to capitalization (%)	N.A.	14.3	N.A.	N.A.	N.A.
Debt per student (\$)	N.A.	826	N.A.	N.A.	N.A.
Pro forma metrics					
Pro forma long-term debt (\$000s)	N.A.	20,413	N.A.	N.A.	N.A.
Pro forma unrestricted reserves to debt (%)	N.A.	40.19	N.A.	N.A.	N.A.
Pro forma debt to capitalization (%)	N.A.	71.1	N.A.	N.A.	N.A.
Pro forma debt per student (\$)	N.A.	12,187	N.A.	N.A.	N.A.

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 GASB75.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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