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## Scuola Vita Nuova Charter School, Missouri; Charter Schools

**Primary Credit Analyst:**

Beatriz Peguero, New York (1) 212-438-2164; [beatriz.peguero@spglobal.com](mailto:beatriz.peguero@spglobal.com)

**Secondary Contact:**

Brian J Marshall, Farmers Branch (1) 214-871-1414; [brian.marshall@spglobal.com](mailto:brian.marshall@spglobal.com)

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# Scuola Vita Nuova Charter School, Missouri; Charter Schools

## Credit Profile

US\$5.7 mil EFF loan ser 2020 dtd 03/31/2020 due 03/31/2050

*Long Term Rating*

BB+/Stable

New

## Rating Action

S&P Global Ratings assigned its 'BB+' rating and stable outlook to Scuola Vita Nuova Charter School, Mo.'s (SVN) issuer credit rating (ICR).

The charter school does not have any public debt. Management, however, currently plans to secure an equitable-facilities-fund (EFF) loan of roughly \$5.7 million on May 1, 2020, to refinance a bank loan and start construction at its single-site-campus expansion.

### Credit overview

We assessed SVN's enterprise profile as adequate, characterized by its excellent academics, stable and growing enrollment, seasoned management, and favorable charter standing. In our opinion, SVN's small enrollment, which we do not expect to vary materially during the next few years and which leaves financial operations highly susceptible to potential enrollment fluctuations, somewhat offsets these strengths. We assessed SVN's financial profile as adequate, demonstrated by its historically robust operating margins, healthy lease-adjusted maximum annual debt service (MADS) coverage, and ample liquidity. A high debt per student ratio balances these strengths, coupled with our expectation financial flexibility will likely weaken as SVN spends down reserves for construction.

We think that, combined, these credit factors led to an indicative standalone credit profile of 'bb+' and a final rating of 'BB+'.

The rating reflects our opinion of SVN's:

- Very small enrollment and limited waitlist, which makes financial operations susceptible to potential enrollment fluctuations;
- High debt per student; and
- Inherent uncertainty associated with charter renewals since the bonds' final maturity exceeds the current charter's period.

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

- Strong academics and community standing, earning a reputation as a safe and well-performing school in Kansas City's underperforming urban core;
- Long operating history of 21 years, helping to earn its 10-year charter term in 2018--SVN is currently the only

charter school awarded this lengthy term by University of Central Missouri (UCM), its authorizer; and

- Small, but prudent, management team with a history of maintaining healthy reserves and positive operations through prior construction projects despite slim revenue.

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 consider an obligation's nature and provisions, bankruptcy-or-liquidation standing, statutory preferences, or legality and enforceability.

SVN, translated as the school of new life, is a single-site public charter school in northeast Kansas City. SVN currently serves 307 kindergarten through eighth-grade students, up from just 192 in fall 2015. SVN, which grew out of a community center, initially focused almost exclusively on the arts. During the past 10 years, however, management has focused more on academics; it has become the area's highest-performing public school, significantly outpacing the unaccredited Kansas City Public School District (KCPD).

SVN aims to break ground on its new facility in summer 2020. The new building will provide additional classrooms for fifth and sixth grades and student space for enrichment activities. Once complete, the new facility's capacity will be 414 students; management expects to reach this enrollment in fall 2029.

The stable outlook reflects S&P Global Ratings' expectation that during the two-year outlook, SVN will likely continue to expand enrollment, produce full-accrual positive operations, and maintain lease-adjusted MADS coverage at or near current levels.

### **COVID-19 response**

Due to COVID-19 and broader public-safety concerns, Gov. Mike Parson declared a state of emergency the week of March 9, 2020. Most public schools have closed, at least through April 3, including SVN. Management has responded by providing learning packets for every student, books to read, and a family learning website created by one of its teachers. Since most students qualify for free and subsidized lunches, management is providing breakfast and lunch every day the school is closed. SVN has designated food pickup times, and it delivers to homes as needed.

A level of uncertainty remains regarding the duration and extent of COVID-19 and its related effect on SVN's performance, including the ability to continue classes, enrollment, and state funding. We think COVID-19 and economic uncertainties could hamper SVN's already slim operating performance should a material amount of unplanned expenses occur. COVID-19's effect on state, federal funding, and emergency reimbursements, however, is currently unknown. We will closely monitor developments for potential credit effects on SVN, and we would take appropriate actions as necessary.

### **Environmental, social, and governance factors**

We analyzed SVN's environmental, social, and governance risks relative to its market position, management and governance, and financial performance and have determined all are in-line with our view of sector standards.

## Stable Two-Year Outlook

### Upside scenario

Although unlikely during the two-year outlook due to SVN's limited size and revenue base, we could raise the rating or revise the outlook to positive if enrollment were to continue to grow in-line with management's expectations to more than 400 students, improving its ability to withstand enrollment fluctuations while increasing debt service coverage (DSC) and liquidity to levels in-line with higher-rated peers. We would also view a larger SVN waitlist positively, providing extra cushion to demand should families leave the area.

### Downside scenario

We could lower the rating or revise the outlook to negative if DSC and margins were to decrease below the rating level. We would also view construction delays negatively because they could severely pressure finances, jeopardizing an already small revenue base. We would also deem pressure on state funding, enrollment decreases, and material expenditure increases due to COVID-19 credit risks to SVN.

## Credit Opinion

## Enterprise Profile

### Economic fundamentals

SVN is in Jackson County. The county's minor population is relatively small at 228,000. The county has consistently experienced a negative growth rate during the past three years. The minor population growth rate should continue to decrease at a rate of 1% during 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, profitability levels and trends, substitution risk, and growth observed in the industry. In our opinion, the charter-school sector represents a moderately high credit risk compared with other industries and sectors.

### Market position

SVN's historically small enrollment poses an ongoing risk to credit stability. In fall 2019, student enrollment grew to 307 from 192 in fall 2015. Although we view management's growth plan and 14.2% growth rate during the past three years positively, we view enrollment of less than 400 as inherently highly vulnerable.

Management aims to continue to build out grades to achieve enrollment growth. SVN started doubling classes per grade in fall 2017, beginning with kindergarten through second grade. By boosting kindergarten enrollment, SVN has grown organically as doubled class sizes move to the next grade. Management plans to grow fifth grade in fall 2020 with enrollment reaching 331. With a novel construction, expected to open in fall 2021, SVN's new facility cap will be 414, above our 400-student threshold. Management, however, does not expect enrollment to reach this level until fall 2029, limiting its enrollment assessment to highly vulnerable during the outlook period.

SVN's waitlist remains highly vulnerable, averaging 13.2% of enrollment during the past three years. We view this negatively because a strong waitlist could offset some pressure due to low enrollment. Despite the slight waitlist, management has not had a problem filling seats or achieving its growth plan. According to management, it will re-evaluate the waitlist after securing the EFF loan. We will continue to monitor these changes.

Healthy student retention and solid academics somewhat offset SVN's small waitlist. Student retention has ranged between 86% and 93% during the past four years. Management attributes student attrition to families moving from the area because most students live within a two-mile radius.

SVN's academic reputation is well known. It has historically outperformed KCPSD in some grades by 2-to-1 in both English language arts (ELA) and math. KCPSD has lost its accredited status off and on since 2000, making SVN an attractive option for students who otherwise would attend KCPSD. SVN's Missouri ELA- and math-assessment-program scores have exceeded nearby charter- and public-school competitors during the past three years, including Guadalupe Centers, Kansas City International, and Garfield Elementary. Notably, SVN's Missouri assessment-program scores are within 97% and 99% of average Missouri ELA and math scores, respectively. This is a considerable accomplishment since SVN's demographics do not compare with the state's demographics.

Roughly 94% of SVN students qualified for free and reduced lunch in fall 2019, slightly down from 96% in fall 2017. Moreover, SVN students speak a myriad of languages at home, including Spanish, Somali, Swahili, Burmese, and Vietnamese. Due to SVN's high percent of English-as-a-second-language students, about 63.1%, it has contracts with English-as-a-second-language tutors; it receives additional state funding to serve these students effectively.

UCM authorizes and sponsors SVN, as it has done since SVN's inception in 1999. UCM has extended SVN's charter four times, the latest of which is for 10 years, expiring in 2028. At the time, this was the longest term UCM granted to any school. UCM gave the other eight Kansas City charter schools it sponsors only five-year terms. UCM reports an exemplary relationship with SVN. In our view, the charter is currently in good standing.

The statutory framework assessment reflects our opinion that while there may be some areas of risk, the framework is not likely to impair SVN's future ability to pay debt service. Missouri provides the majority of public-school operating money. Therefore, charter schools almost entirely depend on the state for operating revenue, subject to annual appropriation by the Missouri Legislature. We expect modest annual state funding increases of about 2% during the next few years.

### **Management and governance**

SVN's senior management team remains stable. The current CEO, with 22 years of education experience, has been with SVN for 10 years. The director of finance and operations, who oversees finances, has been with SVN since 2013; before joining SVN, she managed compliance and finances at another local charter school. The current management team oversaw a construction project a few years ago without any construction delays, coupled with maintaining positive operations. We view this record positively with management taking on a new construction project in summer 2020. There are no changes expected during the outlook period.

A seven-member board, the minimum allowed under bylaws, governs SVN. The board represents a healthy mix of backgrounds, including business and community leaders, educators, and engineers. Management notes that while it is

continually seeking different skillsets for the board, it does not currently plan to add board members during the outlook period. Board members meet monthly and serve three-year terms. Overall, we consider management and the board sufficient; therefore, we do not expect any significant changes during the next few years.

## Financial Profile

### Financial performance

Consistent positive operating margins, with solid pro forma lease-adjusted MADS during the past three fiscal years, characterize SVN's financial performance. Fiscal 2019 financial performance remained relatively steady. Management attributes continued positive performance to its steady enrollment, state funding, and ability to keep expense growth modest. For fiscal year-end June 30, 2019, SVN produced an EBIDA margin of 20.20%, or about \$958,000, which translated to 2.02x pro forma MADS coverage. Furthermore, in fiscal 2019, SVN produced a full-accrual surplus of \$578,000, or a 12.19% margin.

Management expects a positive yet softer full-accrual surplus for fiscal 2020, resulting in pro forma MADS coverage decreasing closer to 1.5x. We expect operations will likely remain positive during the next few fiscal years; we, however, expect results to decrease due to additional costs associated with expansion plans. Projections indicate DSC will be about 1.4x-1.7x during the next few fiscal years; ultimately, however, the surplus will depend on whether SVN can manage expansion expenses in-line with projections and meet enrollment projections. Total revenue is slightly above \$5 million due to SVN's relatively small size, but it has been increasing during the past few fiscal years.

### Liquidity and financial flexibility

At fiscal year-end 2019, SVN had about \$1.85 million, or 174 days' cash on hand, which we consider healthy for the rating. Unrestricted reserves should decrease for fiscal 2020, closer to \$1.425 million, or 114 days' cash on hand, due to capital expenditures and expenditure growth. Management does not currently have any additional plans to draw down reserves beyond fiscal 2020, and it expects to continue to build reserves due to positive operations. Days' cash on hand, however, should not improve much beyond 115 days' because the expense base should grow. We expect controlled expenditure growth and steady operating performance to assist SVN with maintaining good liquidity. SVN's unrestricted reserves for fiscal 2019 were 21.3% of pro forma debt, which we view as sufficient for the rating category.

### Debt

SVN does not have any debt outstanding other than an EFF loan of roughly \$5.7 million. Pro forma annual lease-adjusted debt service equals pro forma MADS of roughly \$471,000, or modest debt of about 10.2% of expenditures. SVN does not have any additional contingent liabilities or off-balance-sheet debt. We view debt as manageable for the rating. We understand SVN does not currently plan to take on additional debt. In our view, overall debt should decrease as SVN grows into its debt.

As with many charter schools, SVN's debt-to-capitalization ratio shows significant pro forma balance-sheet debt; for fiscal 2019, this ratio was 54%, which was relatively low compared with similar-rated peers. We view debt as a positive rating factor, and we expect these ratios will likely continue to improve.

SVN participates in the Kansas City Public School District Retirement System, a cost-sharing, multiple-employer,

defined-benefit plan run by KCPSD. The funding ratio, as of the 2016 measurement date, was 70.1%, which we view as adequate. In fiscal 2019, SVN's pension contribution was about 4% of total expenses, which we consider low. We will continue to monitor SVN's pension burden because the fiscal 2019 audit indicates its contribution should increase to 12% from 10.5% beginning on Jan. 1, 2020. We view contributions compared to SVN's budget as still manageable; we, however, will continue to monitor the effect, if any, of the recently adopted measures on SVN's financial profile.

### Financial policies

SVN 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 affect its future ability to pay debt service negatively. SVN regularly accesses short-term borrowing to meet working-capital needs, which we view as a weakness. Our financial-policies analysis includes a review of SVN's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure; we compare these policies with similar institutions.

Scuola Vita Nuova Charter School, Missouri Select Enterprise And Financial Statistics					
	--Fiscal year-end June 30--				Medians for 'BB+' rated charter schools
	2020p	2019	2018	2017	2018
<b>Enrollment</b>					
Total headcount	307	279	253	207	1,147
Total waitlist	23	44	54	54	MNR
Waitlist as a % of enrollment	7.5	15.8	21.3	26.1	18.5
<b>Financial performance</b>					
Accounting standard	N.A.	FASB	FASB	FASB	N.A.
Total revenue (\$000s)	N.A.	4,743	4,557	3,482	13,409
Total expenses (\$000s)	N.A.	4,165	3,615	3,064	MNR
EBIDA (\$000s)	N.A.	958	1,238	698	MNR
EBIDA margin (%)	N.A.	20.2	27.2	20.0	14.9
Excess revenue over expenses (\$000s)	N.A.	578	942	418	MNR
Excess income margin (%)	N.A.	12.2	20.7	12.0	3.4
Operating lease expense	N.A.	24	14	N.A.	MNR
Pension/other postemployment benefits (OPEB) adjustments (\$)	N.A.	N.A.	N.A.	N.A.	MNR
Lease-adjusted annual debt service (\$)	N.A.	189	2,267	232	MNR
Lease-adjusted annual debt service coverage (x)	N.A.	5.20	0.55	3.01	MNR
Lease-adjusted annual debt service burden (% of total revenue)	N.A.	4.0	49.7	6.7	MNR
Lease-adjusted maximum annual debt service (MADS) (\$000s)	N.A.	471	471	471	1,686
Lease-adjusted MADS coverage (x)	N.A.	2.08	2.66	1.48	1.40
Lease-adjusted MADS burden (% of total revenue)	N.A.	9.9	10.3	13.5	13.1
Pro forma MADS (\$000s)	N.A.	471	471	471	MNR

## Scuola Vita Nuova Charter School, Missouri Select Enterprise And Financial Statistics (cont.)

	--Fiscal year-end June 30--				Medians for 'BB+' rated charter schools
	2020p	2019	2018	2017	2018
Pro forma lease-adjusted MADS coverage (x)	N.A.	2.08	2.66	1.48	MNR
Pro forma lease-adjusted MADS burden (% of total revenue)	N.A.	9.9	10.3	13.5	MNR
Total revenue per student (\$)	N.A.	17,000	18,012	16,821	MNR
<b>Balance sheet metrics</b>					
Unrestricted reserves (\$)	N.A.	1,852	1,393	2,621	MNR
Days' cash on hand	N.A.	174.3	149.1	333.3	102.0
Total long-term debt (\$000s)	N.A.	2,100	2,172	2,136	MNR
Unrestricted reserves to debt (%)	N.A.	88.2	64.1	122.7	16.9
Unrestricted net assets as a % of expenses	N.A.	187.0	195.7	199.8	24.9
Debt to capitalization (%)	N.A.	22.5	24.6	27.1	86.0
Debt per student (\$)	N.A.	7,527	8,585	10,319	15,524
<b>Pro forma metrics</b>					
Pro forma unrestricted reserves (\$000s)	N.A.	1,852	N.A.	N.A.	MNR
Pro forma days' cash on hand	N.A.	174	N.A.	N.A.	MNR
Pro forma long-term debt (\$000s)	N.A.	8,700	2,172	2,136	MNR
Pro forma unrestricted reserves to debt (%)	N.A.	21.3	N.A.	N.A.	MNR
Pro forma debt to capitalization (%)	N.A.	55.0	25.0	27.0	MNR
Pro forma debt per student (\$)	N.A.	31,183	8,585	10,319	MNR

p--Projected. N.A.--Not available. MNR--Median not reported. FASB--Financial Accounting Standards Board. 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 + 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 Governmental Accounting Standards Board Statement Nos. 68 and 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



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