

Research

Summary:

KIPP Public Schools Northern California; Charter Schools

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Long Term Rating

BBB/Stable

Current

Rationale

S&P Global Ratings' issuer credit rating (ICR) on KIPP Public Schools Northern California (KIPP NorCal), is 'BBB'. The outlook is stable.

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 the obligation's nature and provision, standing in bankruptcy or liquidation, statutory preferences, or legality and enforceability.

KIPP Bay Area Real Estate (KBARE) is a California not-for-profit corporation formed to finance, develop, lease, and maintain school facilities for KIPP NorCal. KIPP NorCal is a California not-for-profit corporation established in 2002 with the opening of Bridge Academy in Oakland, the first KIPP NorCal school. Today, KIPP NorCal operates a network of 16 schools via 15 authorized charters serving more than 6,557 students in fall 2020. Two of these schools serve elementary students, seven are middle schools, two offer kindergarten through eighth grades, and five are high schools. All of the schools were historically in the San Francisco Bay area; however, KIPP NorCal will open its first school in Stockton, KIPP Stockton Middle School, in August 2021. KBARE currently has two members--KIPP Bridge and KIPP Heritage--that constitute the obligated group. However, KIPP NorCal intends to enter into a second loan with the equitable-facilities fund (EFF) to purchase the KIPP Esperanza High School Building; after the acquisition of this loan, KIPP Esperanza will be part of the obligated group. Previously, KBARE acquired a \$16-million loan from the EFF to refinance two construction loans from Pacific Charter School Development and reimburse KIPP NorCal for previous equity contributions.

Revenue of the three obligated KIPP NorCal schools will secure the loans. Based on our group-rating-methodology criteria, published July 1, 2019, on RatingsDirect, our rating analysis encompasses the entire KIPP NorCal organization from the network approach to general strategy and shared oversight. Specifically, our highly strategic-group assessment reflects the three schools' role and importance to KIPP NorCal. We view the obligated group as important to the organization with parent support of the obligated group likely in the event of operating difficulties; however, the obligated group represents only 17% of total organization enrollment and revenue, which limits our view of the group status to highly strategic. The ICR applies only to KBARE, which represents the obligated group, not to KIPP NorCal as an organization. Financial metrics cited in this report reflect those of the entire KIPP NorCal organization unless

otherwise specified.

Following COVID-19, KIPP NorCal transitioned to online instruction. Campuses will reopen in three phases. Phase 1 will open campuses to small groups of students, prioritizing those who are struggling the most with distance learning. Many campuses have already launched phase 1, and some staff and students returned to campus as early as October 2020. Phase 2 will provide TK-4 students with the option for in-person instruction, as space allows, assuming counties have returned to California's red tier. Phase 3 will allow for the return of full grade levels for in-person instruction at middle or high school levels. Management continues to monitor relevant health-and-safety guidelines, and it adjusts plans as necessary.

On June 29, 2020, Gov. Gavin Newsome approved the state's 2021 budget, closing a massive \$54.3 billion COVID-19-related budget shortfall. The adopted budget reverses the governor's initial budget proposal for a 10% funding reduction in the local-control-funding formula and maintains apportionment funding at fiscal 2020 levels, but it does not provide the 2.31% cost-of-living adjustment. Per-pupil funding was initially held flat for fiscal 2021 based on 2019-2020 average daily attendance, a hold-harmless provision; however, to address funding risks, the state passed an education trailer bill, Senate Bill 820 (SB 820), to accommodate school districts and charter schools with increasing enrollment to claim higher funding. In addition, instead of imposing cuts, the preliminary budget includes a 3.84% local-control-funding-formula cost-of-living adjustment, a retirement of two-thirds of public-funding deferrals, and significant one-time funding for learning recovery.

KIPP NorCal had roughly \$107.6 million in unrestricted cash reserves at fiscal year-end 2020, or 447 days' cash on hand, which we think is more-than-sufficient liquidity to cover potential funding pressure. In addition, KIPP NorCal received roughly \$15 million in one-time federal Coronavirus Aid, Relief, & Economic Security Act funds and one-time federal COVID-19-relief funds. We will monitor economic conditions, particularly uncertainty related to COVID-19 and state aid due to state budgetary pressure.

Credit overview

We assessed KIPP NorCal's enterprise profile as strong, characterized by its growing enrollment, solid demand with a healthy waitlist, good academics, and sophisticated and highly capable management team. We assessed KIPP NorCal's financial profile as adequate, characterized by its consistently positive operating performance, robust unrestricted reserves, and healthy pro forma maximum annual debt service (MADS) coverage. In our opinion, management's aggressive expansion plans and lease-renewal risks, with 11 of the 16 school facilities leased, offset this.

We think that combined, these credit factors led to an indicative standalone credit profile for KIPP NorCal of 'bbb+'. The ICR is based on our group-credit profile on KIPP NorCal and our view that the obligated group is highly strategic to the organization. Due to the obligated group's highly strategic status, the ICR is one notch below that on the group-credit profile.

The rating also reflects our view of KIPP NorCal's:

- Growing enrollment and ample demand;
- Exceptional liquidity with unrestricted cash and investments of more than 447 days' cash on hand, as of June 30, 2020;

- History of excellent full-accrual operating surpluses, resulting in solid MADS coverage; and
- Sophisticated management team with sound governance practices, solid fundraising history, and thoughtful strategic planning.

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

- Rapid medium-term expansion plans, which inherently present some uncertainties and risk; and
- Potential that various charters could be revoked or not renewed due to noncompliance with charter terms, as with all charter schools, prior to the bonds' final maturity.

KIPP NorCal is part of the larger Knowledge is Power Program (KIPP) network of schools formed in 1994. More than 220 schools in 20 states and Washington, D.C., serving more than 100,000 students, are part of the larger KIPP network. About 90% of KIPP's students are from low-income families and eligible for the federal free or reduced-price meals program.

Total pro forma debt, including the second EFF loan, should be roughly \$30.8 million. Revenue of the related schools in the obligated group and a mortgage on the real estate owned by each limited-liability company associated with each school secures the loans. Officials used prior debt proceeds to refinance the construction of KIPP Heritage Academy's facility, a \$10-million middle-school project; this facility, completed in 2017, is on a portion of the Los Arboles Elementary School. In addition, officials used prior-debt proceeds to refinance a project related to annexing KIPP Bridge Academy and fund a \$10-million expansion project to house the newly established elementary grades when the school expanded to offering K-8 from just middle school. This facility, completed in 2018, is in Oakland, next to KIPP Bridge's main school building, leased to KIPP NorCal by Oakland Unified School District. Officials will use the second loan to acquire the KIPP Esperanza High School building.

The stable outlook reflects S&P Global Ratings' expectation that KIPP NorCal will continue to grow enrollment and maintain its enterprise profile strength. We also expect KIPP NorCal will prudently manage its growth and continue to generate good operating surpluses and steady fundraising so that liquidity and MADS coverage remain commensurate with the rating. We expect to evaluate the entity's expansion plans relative to the organization's profile once there is further clarity.

Environmental, social, and governance (ESG) factors

The charter-school sector is facing elevated social health-and-safety risks due to COVID-19-related social distancing on state tax revenue, which is the main charter-school-funding source. Despite elevated social risk, we think KIPP NorCal's environmental and governance risks are in-line with our view of the sector standard.

(For more information about KIPP NorCal, see the full analysis, published April 29, 2021, on RatingsDirect.)

Stable Outlook

Downside scenario

We could lower the rating or revise the outlook to negative if enrollment or funding pressure were to constrain operations or the issuance of material additional debt were to lead to sustained MADS coverage or liquidity considerably below current levels. Although we think KIPP NorCal has taken steps to address the ongoing effects of COVID-19 on its finances, we could also lower the rating or revise the outlook to negative if unforeseen pressure related to COVID-19 were to affect demand, finances, or the organization's trajectory materially.

Upside scenario

We are unlikely to raise the rating during the two-year outlook due to the organization's planned expansion. Uncertainty surrounding proposed legislation that could greatly affect KIPP NorCal' market position also limits potential to raise the rating. However, we could raise the rating beyond this timeframe if KIPP NorCal were to maintain its enterprise profile characteristics, sustain healthy MADS coverage and robust unrestricted reserves, and successfully absorb additional debt.

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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