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Alma del Mar Charter School, Massachusetts; Charter Schools

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Alma del Mar Charter School, Massachusetts; Charter Schools

Credit Profile

ICR

Long Term Rating

BB/Stable

New

Rating Action

S&P Global Ratings assigned its 'BB' issuer credit rating to Alma del Mar Charter School (Alma), Mass. The outlook is stable.

The school's debt profile includes a proposed \$21 million Equitable Facilities Financing (EFF) loan and series 2015 bonds issued by the Massachusetts Development Finance Agency for the Alma del Mar Foundation Inc., a tax-exempt 501c-3 organization, on behalf of Alma del Mar Charter School. With the EFF 30-year loan, the school will have \$30.1 million in debt outstanding, net of a \$14.5 million new market tax credit (NMTC), which we expect will unwind in 2022. The Alma del Mar Foundation was the leveraged lender, with a note receivable in the amount of \$10.04 million, offsetting the majority of the \$14.1 million obligation; therefore, we recognize only the balance of the obligation in our long-term debt figures. The series 2015 bonds are on parity with the EFF loan. The EFF loan will be secured by a first-lien pledge on net revenues from Alma del Mar Foundation Inc. and the mortgage on Alma I and the Alma II facility to be constructed.

Alma issued the series 2015 bonds to finance the acquisition and related construction of a 450-student-capacity, K-8 facility in New Bedford, Mass. (Alma I). The 2020 loan transaction will fund acquisition and construction of a second K-8 facility (Alma II) approximately 2.5 miles from Alma I. Project completion is scheduled in time for the fall 2021 semester, and the facility will accommodate 594 students. The school is leasing space for Alma II, which serves students in K-2 and grade 6. The school plans to add a grade level each year at the elementary and middle school levels until it reaches K-8 by fiscal 2024.

In response to the COVID-19 outbreak, Alma transitioned to distance learning in March 2020. State testing was suspended for the 2019-2020 academic year, and management reports minimal financial disruption from the pandemic during fiscal 2020. The school began the fall 2020 semester on September 14, with online instruction. Only students with extenuating circumstances will be allowed on campus for in-person instruction. Management will evaluate the possibility of providing in-person instruction for the broader student population as the year goes on.

Despite the recession, Alma del Mar received fiscal 2020 per pupil revenue in full without deferrals. The school anticipates funding will be flat for fiscal 2021, based on guidance from the Division of Local Services on the governor's draft budget. The school also received \$257,000 in relief funding from the Coronavirus Aid, Relief, and Economic Security (CARES) Act, and an additional \$72,000 in donations from private foundations to assist with the transition to distance learning. We continue to monitor developments in school operations for fall 2020 and the progress made in

completing the 2020-2021 academic year as more details become available.

Credit overview

We assessed Alma's enterprise profile as adequate, characterized by growing enrollment, high student retention rates, a history of the waitlist exceeding enrollment, good working relationship with the authorizer, and a stable management team. These considerations are partially offset by the school's weaker academic performance relative to the state across multiple grade levels. We assessed Alma's financial profile as vulnerable based on the recent history of mixed full-accrual operating results, with modest operating performance expected until the school completes its current facility expansion; limited pro forma maximum annual debt service (MADS) coverage; and meaningful indebtedness relative to the total enrollment of the school. These risks are partially offset by the school's meaningful liquidity above 100 days' cash on hand (DCOH).

The rating reflects our view of Alma's:

- Demand from the local community, as evidenced by the school's strong retention and ability to grow while historically maintaining its waitlist above the level of enrollment--although in the near term social distancing has limited the school's ability to recruit in person;
- Sufficient liquidity position to withstand some of the financial pressures associated with the pandemic and recession, with over 100 days' cash on hand at the end of fiscal 2019;
- Rapidly growing revenue base and enrollment, and
- Good relationship with the charter authorizer.

The above strengths are offset by:

- Weaker academic performance relative to state averages, although Alma's academic performance is significantly higher than that of the local school district;
- Uncertainty related to the 2020 project's construction and forecast enrollment growth;
- A history of operating results near or below breakeven, with consistent breakeven operations not expected until fiscal 2022 at the earliest as the school grows to capacity; and
- The risk, common to charter schools, that Alma's charter could be revoked or not renewed, prior to the maturity of its debt, which extends well beyond the charter term.

The stable outlook assumes the school will be successful in obtaining a five-year charter renewal prior to the expiration date of June 30, 2021. The outlook also reflects our expectation that Alma's enrollment will continue to increase, enabling the school to generate operational surpluses, and MADS coverage and liquidity commensurate with those of rated peers. Despite the stable outlook, the extent of the disruption from COVID-19 and the associated recession are unknown, and additional unexpected impacts could create further near-term pressure. We continue to monitor developments and associated pressures as they take shape.

Alma del Mar was founded in 2011, and is located in New Bedford, in Bristol County, about 60 miles south of Boston. Alma's charter was renewed by the Massachusetts Department of Elementary and Secondary Education (DESE) in

2016 for five years through June 30, 2021. In 2019, the charter was amended to increase the number of students allowed to 1,044 from 450. DESE is reviewing Alma's charter for its second five-year renewal term, with a decision expected in early 2021. Alma uses the expeditionary learning model centered on project-based learning with exploration of key topics in six-12 week intervals. The school serves students in kindergarten through eighth grade, with an enrollment of about 792 expected for fall 2020.

Environmental, social, and governance (ESG) 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 ESG factors. We believe this is a social risk for Alma due to its dependence on state funds for most of its revenue, and there are potential decreases in state funding beyond fiscal 2021 as a result of recessionary pressures. Despite the elevated social risk, we believe the school's environmental and governance risk are in line with our view of the sector as a whole.

Stable Outlook

Downside scenario

We could take a negative rating action in the event Alma is unable to manage growth into the new facility, leading to the school missing enrollment projections, or due to construction delays. In addition, we could lower the rating if financial metrics weaken significantly due to deficit operating performance such that MADS coverage and liquidity do not remain in line with the current rating level. We could also take a negative rating action if the school's charter is not renewed in 2021, although we believe the likelihood of non-renewal is remote.

Upside scenario

We view a positive rating action as unlikely over the outlook period, given the current recessionary environment, the school's rapid expansion plan, and its high debt metrics.

Credit Opinion

Enterprise Profile

Economic fundamentals

Alma is in New Bedford, in Bristol County. The county's minor population is healthy at about 165,000, and is expected to decrease over time with projections indicating a modest decline of 3.3% through 2025.

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

Alma, entering into its ninth year of operation in fall 2020, has a favorable demand profile, characterized by growing enrollment, a sizable waitlist, and a history of student retention above 90%. We expect these characteristics will remain resilient despite pressures presented by COVID-19, and will hold beyond fall 2020. The preliminary waitlist for fall 2020 is 512 students, 27% lower than the 703 students in fall 2019. We believe the decline is attributable to the disruption of the school's traditional methods of recruiting, including door-to-door visits, remaining unavailable due to social distancing guidelines. Alma is expanding, drawing some students from the waitlist to fill available seats at the school, so we believe the lower level of waiting students is not indicative of a decline in demand.

Based on our discussions with management and the charter authorizer, we expect Alma's charter contract will be renewed for five years, the standard length of a charter contract in Massachusetts. The authorizer noted the school is in compliance with all required filings, and its academic performance for some of the grades at the elementary level were below the state average on the Massachusetts Comprehensive Assessment System evaluation. Overall, however, we believe Alma does well academically, as evidenced by consistently outperforming the local school district. State testing was waived for the 2019-2020 academic year. At the time of this report, there is a possibility state testing could be administered in the 2020-2021 academic year.

Management

Alma outsources several business functions to external firms HR Knowledge and Central Source, including human resources, payroll, information technology support, financial reporting, and compliance reporting, in exchange for a fee (\$20,000 and \$75,000 annually, respectively). Both contracts are renewed annually.

The school has a nine-member board with diverse experience across education, finance, law, and consulting. The bylaws allow the board to expand up to 18 members and limits terms to three consecutive three-year terms. We view management as sufficiently diverse and actively engaged in mitigating risk while looking for opportunities to expand. We expect management will remain largely stable over the outlook period.

Financial Profile

Financial performance

As Alma has expanded, it has experienced volatile operating performance. Since fiscal 2016, the school has had multiple years of full-accrual deficits coupled with sparse surpluses. In fiscal 2019, Alma generated a full-accrual surplus of \$453,000, a sizable improvement from the \$228,000 deficit in fiscal 2018, representing net income margins of 5.1% and negative 3.1%, respectively. The stronger operations are attributed to contribution income, which increased to \$1.1 million from \$456,000. Although there have been multiple years of deficits, Alma has consistently generated positive earnings before interest depreciation and amortization (EBIDA), which approximates operating cash flow, and benefits from favorable EBIDA margins of 15.5% and 9.31%, respectively, in fiscal years 2019 and 2018. Based on debt service projections from the EFF loan, we anticipate pro forma MADS of \$1.78 million occurring in fiscal 2024, translating to pro forma MADS coverage of 1.15x based on fiscal 2019 results. We expect MADS coverage and broader financial performance will improve, driven by increasing per pupil revenues from additional student enrollment as the school continues to grow into its facilities.

Liquidity and financial flexibility

Alma's liquidity position dipped slightly to 151 days' cash on hand in fiscal 2019 from 154 days in fiscal 2018, which we consider sufficient. Alma's unrestricted reserves represent 7.3% of pro forma debt in fiscal 2019. As of fiscal year-end 2019 (June 30), the school had unrestricted reserves of \$3.3 million. As Alma executes its expansion plan, we expect its cash levels on a relative basis will decline as the school moves toward full enrollment by 2023, with continued operating surpluses and sufficient cash flow, offset by growth in the expense base.

Debt burden

In consideration of the proposed EFF loan, Alma has approximately \$30.1 million in debt outstanding on a pro forma basis, with MADS occurring in fiscal 2024. The school's debt burden based on year-end fiscal 2020 revenue, is approximately 17.5%. Alma has a \$300,000 undrawn line of credit and there are no contingent liabilities or off-balance-sheet debt. The \$30.1 million does not include the NMTC generated in the transaction with JP Morgan Chase to provide financing for the construction of Alma I; the position is expected to be unwound in fiscal 2023.

As it does for most charter schools, debt represents the overwhelming portion of Alma's capital structure, with pro forma debt-to-capitalization of 93.9% based on the fiscal 2019 balance sheet. Although sizable, the debt burden is comparable with the rating median. At this time, the school has no plans to issue additional debt. We expect Alma's debt burden will improve as the school makes its periodic debt service payments, with improved capacity from the ongoing facility expansion.

Financial policies

The school has formal policies for risk management, liquidity, and debt. Alma meets standard annual disclosure requirements. The financial policies assessment reflects our opinion that, while there may be some areas of risk, the organization'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 organization's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure, as well as a comparison of these policies with those of similar peers.

Related Research

- 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

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