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California School Finance Authority Alliance for College-Ready Public Schools; Charter Schools

Primary Credit Analyst:
Kaiti Wang, CFA, New York 212-438-0566; kaiti.wang@spglobal.com

Secondary Contact:
Shivani Singh, New York (1) 212-438-3120; shivani.singh@spglobal.com

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California School Finance Authority
Alliance for College-Ready Public Schools; Charter Schools

Credit Profile		
US$13.49 mil Sch Fac Rev Bnds (Private Taxable) (Alliance for Coll - Ready Pub Schs) ser 2019B due 07/01/2045		
Long Term Rating	BBB/Stable	New
US$8.995 mil Sch Fac Rev Bnds (Pub Taxable) (Alliance for Coll - Ready Pub Schs) ser 2019A due 07/01/2033		
Long Term Rating	BBB/Stable	New
US$6.51 mil Sch Fac Rev Bnds (Private Tax-Exempt) (Alliance for Coll - Ready Pub Schs) ser 2019C due 07/01/2049		
Long Term Rating	BBB/Stable	New
California Sch Fin Auth, California		
Alliance for Coll - Ready Pub Schs, California		
Alliance for Coll Ready Pub Sch CHARTERSCH		
Long Term Rating	BBB/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'BBB' long-term rating on the California School Finance Authority's series 2019 A, B, and C school facility revenue bonds, issued for Alliance for College-Ready Public Schools (Alliance). At the same time, S&P Global Ratings affirmed its 'BBB' long-term rating on the authority's series 2015, 2016A, 2016B, 2016C, and 2016D school facility revenue bonds, issued for Alliance. The outlook is stable. The rating applies only to the series 2015, 2016, and 2019 bonds and not to Alliance as an organization.

Based on our group rating methodology published Nov. 19, 2013 on RatingsDirect, the rating analysis encompasses the entire Alliance for College-Ready Public Schools organization. The 'BBB' rating is based on our group credit profile on Alliance (bbb) and our view that the 15 schools (three schools will be added to the obligated group upon closing of the 2019 bonds) that are obligated to support the bonds are core to the organization given that the obligated group constitutes a significant 45% of assets, 57% revenue, and 65% of enrollment of Alliance. The entire Alliance organization consists of the Alliance home office and its 25 schools, which includes the obligated group. Given the obligated group's core status, the rating is equal to that on the group credit profile of Alliance. Financial metrics cited in this report, unless otherwise indicated, reflect those of the entire Alliance organization.

We assessed Alliance's enterprise profile as strong, characterized by a diverse demand profile with its 25 schools located throughout the greater Los Angeles area, solid retention rates, and experienced management team. We assessed Alliance's financial profile as adequate, with weakened and deficit operating margins in 2018, which we anticipate will improve in fiscal 2019, a moderate debt burden, and three schools that recently became parties to representation proceedings initiated by a union, which could slightly pressure future operations. We believe that, combined, these credit factors lead to an indicative stand-alone credit profile of 'bbb' and a final rating of 'BBB'.

The 'BBB' rating reflects our view of Alliance's:

- Wide and diverse coverage within Los Angeles County with 25 separately chartered schools, and large enrollment of over 13,000 total students, which helps insulate it from enrollment declines at individual schools;
- Good liquidity;
- Healthy pro forma lease-adjusted maximum annual debt service (MADS) coverage of 1.75x for fiscal 2018;
- Successful renewal of all six schools that were up for renewal in the 2018-2019 year; and
- Experienced and savvy management.

Partly offsetting the above strengths, in our view, are:

- Much weaker operations in fiscal 2017 and 2018, compared to historical years though we still anticipate positive operations in fiscal 2019;
- Aggressive use of debt, including the use of balloon payments, though management has had a successful track record of refinancing; and
- Risk, as with all charter schools, that the school can be closed for nonperformance of its charter or for financial distress prior to the final maturity of the bonds.

The series 2019 bonds are secured by revenue of the 15 obligated Alliance schools, which, as defined in the governing bond documents, consists primarily of per pupil funding from the state. The bonds are on parity with the obligated groups' $139 million outstanding series 2015 and 2016, issued under the same master indenture.

The obligated Alliance schools are as follows with the last three as the newly added schools upon closing of the series 2019 bonds:

- Alliance Marc & Eva Stern Math & Science School;
- Alliance Virgil Roberts Leadership Academy [formerly College-Ready Leadership Middle Academy (formerly No. 7)];
- Alliance Ted K. Tajima High School (formerly High School No. 16);
- Alliance Renee and Meyer Luskin Academy High School;
- Alliance College-Ready Middle Academy No. 12;
- Alliance Kory Hunter Middle School (formerly No. 9);
- Alliance Collins Family College-Ready High School;
- Alliance Judy Ivie Burton Technology High School;
- Alliance College Ready Middle Academy 4;
- Alliance Cindy and Bill Simon Technology Academy High School;
- Alliance Piera Barbaglia Shaheen Health Services Academy (formerly Health Services Academy);
- Alliance Marine Innovation and Technology 6-12 Complex (formerly College – Ready Academy 21);

- Alliance College-Ready Middle Academy No. 8;
- Alliance Ouchi-O'Donovan 6-12 Complex; and
- Alliance Jack H. Skirball Middle School.

Alliance was incorporated in 1991 as the result of a merger between Los Angeles Educational Alliance for Reform Now (LEARN) and Los Angeles Annenberg Metropolitan Project (LAAMP), and opened its first charter high school in 2004. Alliance was formed as a nonprofit organization working to create a network of small, high-performing public schools spanning grades nine through 12 and six through eight in Los Angeles. Alliance manages 15 public high schools, seven middle schools, and three sixth- through 12th-grade complexes, all in the Los Angeles Unified School District (LAUSD). There have been no plans for increasing the amount of schools in recent years nor in the near future. Its enrollment as of fall 2018 is approximately 13,000 students (8,217 for the 15 obligated group schools). The average percentage of students designated as having low socioeconomic status is very high at 94%.

Outlook

The stable outlook reflects our view that Alliance will continue to attract enough students and tighten its enrollment projections and expense controls to generate surplus operations on a full-accrual basis and maintain liquidity and coverage at levels commensurate with the rating.

Downside scenario

We could take a negative rating action during the two-year outlook period in case of a substantial enrollment decline, continued weakness in operations such that MADS coverage reduces to levels not commensurate with peers, or a material deterioration of the balance sheet. A negative rating action could occur if the obligated group does not maintain its financial covenants or if a charter is revoked or not renewed.

Upside scenario

Although we are unlikely to do so during the two-year outlook period, we could raise the rating if Alliance increases and maintains liquidity and coverage at levels supportive of a higher rating.

Enterprise Profile

Economic fundamentals

Alliance is located in Los Angeles County. The county's student-aged population is exceptional at over 3 million but is expected to decline at a rate of 6.2% through 2024.

Industry risk

Industry risk addresses our view of the charter school sector's overall cyclicality and competitive risk and growth through application of 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 the school's enrollment and demand profile as healthy, supported by growing enrollment in conjunction with a robust retention rate. Total enrollment has grown an annual average of 5% over the past four years, although we expect that the growth will continue to temper during the outlook period. For fall 2018, enrollment totaled 12,707 students. Alliance's wait list was not reported for fall 2017, however the total waitlist for fall 2018 is 2,402, or what we view as a somewhat limited 18% of enrollment. Alliance maintains a specialized market position to promote college readiness for underserved students in the Los Angeles area. Alliance outperformed its local school district, but scores somewhat lower than the state average. Based on 2017-18 test scores, the average of all Alliance high schools outperformed its local school district (LAUSD) and the state average. Middle School performance is weaker than the state average and slightly below to average compared to LAUSD. We anticipate no significant changes to the Alliance's demand profile over the next few years.

We view the school's standing with the authorizer as good. Alliance is authorized by the LAUSD, and all but one of the schools within the Alliance network have received at least one charter extension.

In our view the statutory framework could hamper the school's ability to meet debt service, as the charter authorizer is the local public school district and the authorizer competes for students. In our view, Alliance and the charter authorizer do not have a collaborative relationship.

Under the state's Local Control Funding Formula (LCFF), local educational agencies receive funding based on the demographic profile of the students they serve. The LCFF creates three funding mechanisms: a base grant for all students; supplemental grants equal to 25% of the base grants for each English learner, economically disadvantaged student, and foster youth enrolled in excess of 55% of total enrollment; and supplemental grants equal to 50% of the base grant provided for each student above the 55% threshold. The funding formula for Alliance is positive given its high portion of economically disadvantaged students.

Management and governance

We view the management team as capable and governance structure a positive contributor to the organization's healthy demand and positive financial performance. Alliance is governed by a diverse 22-member board of directors and an experienced management team. Each campus maintains its own board of directors made up of nine members, five of whom are appointed by the Alliance board. In our opinion, the majority membership of Alliance-appointed board members on each school's board allows management to have direct control over each school, which increases efficiency and consistency among all Alliance schools. Each school maintains ties and a management agreement with Alliance as the Charter Management Organization arm of the organization. Alliance provides a variety of support services, including payroll, benefits, information technology, human resources, fundraising, institutional guidance, and finance and budgeting, for which it is paid an administrative services fee. Alliance provides financial support to its member schools, if needed, by reducing its administrative services fee, enacting rent equalization among the properties that it owns and leases to schools, and through intercompany lending.

In our view, management continues to be active in assessing the school's long-term goals and applying solutions to meet those goals, though it lacks a formal strategic plan. It has set a high academic standard that continues to strengthen the overall school's profile within the market. Management manages financial operations acceptably. We view management as solid and anticipate no changes in the next few years.

Financial Profile

Financial performance

Alliance's operations in fiscal 2017 and 2018 weakened from prior years due to lower enrollment than budgeted and rising benefit costs, though we understand management has assessed the causes and expects to see improved operations in fiscal 2019 after instituting measures to project enrollment more accurately and tighten expenses. For the fiscal year ended June 30, 2017, Alliance produced a full-accrual surplus of $1.8 million or a 1% excess margin. For the fiscal year ended June 30, 2018, Alliance produced a full-accrual surplus of $1.27 million, equal to a 0.67% margin, translating to 1.75x pro-forma lease adjusted MADS, viewed as acceptable for the rating. We anticipate improvements in fiscal 2019 based on management's strategies, but view the three schools that recently became parties to representation proceedings initiated by a union as adding some pressure for operations beginning in fiscal 2020 when collective bargaining contracts is expected to begin.

Liquidity and financial flexibility

The school's liquidity position is sufficient for the rating. As of fiscal year-end 2017 and 2018, the school had 161 and 149 days' cash on hand, respectively. Management has no plans to draw down its cash position. Despite recent declines in liquidity position, we expect a return to positive operating performance in fiscal 2019 to assist the school in maintaining a sound liquidity position.

Alliance's pro-forma unrestricted reserves as a percentage of debt for fiscal 2017 and 2018 was 25% and 20%, respectively; we view this as acceptable for the rating.

Debt burden

Alliance will have about $271 million of debt outstanding including the pro forma series 2019, with smoothed pro-forma lease adjusted MADS of $15.1 million. Total debt service is smoothed over 34 years remaining on the bonds to obtain the smoothed pro-forma MADS calculation, which translates to a manageable pro-forma debt burden of about 8.0% of revenues for fiscal 2018. We understand the organization refinanced approximately $6.5 million of a bullet maturity originally due in 2021 out to 2031 (not on parity with/not part of the obligated group). Somewhat offsetting this risk, in our view, is Alliance's ample liquidity and sufficient market access as evidenced by its track record of successfully refinancing prior debt, which should allow it to refinance the payments before they come due. The school has no additional contingent liabilities or off-balance-sheet debt. The organization's pro-forma debt-to-capitalization ratio for fiscal 2018 was 67.78%, which we view as satisfactory for the rating.

Financial policies

Alliance meets standard annual disclosure requirements. The financial policies assessment reflects our opinion that, despite areas of risk, the organization's overall financial policies are not likely to hamper 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 and a comparison of these policies with those of comparable providers.

Alliance For College-Ready Public Schools (Consolidated) - GCP, Calif.: Enterprise And Financial Statistics

Alliance For College-Ready Public Schools (Consolidated) - GCP, Calif.: Enterprise And Financial Statistics (cont.)

	--Fiscal year ended June 30--					--Medians for 'BBB' rated charter schools--
Enrollment	**2019**	**2018**	**2017**	**2016**	**2015**	**2017**
Total headcount	13,327	12,707	12,197	11,644	10,931	2,395
Total waiting list	2,402	N.A.	3,204	3,885	2,852	MNR
Waiting list as % of enrollment	18.00	N.A.	26.30	33.40	26.10	42.60
Financial performance						
Total revenues ($000s)	N.A.	190,408	178,119	185,116	142,160	23,549
Total expenses ($000s)	N.A.	189,136	176,280	162,807	127,435	MNR
EBIDA ($000s)	N.A.	23,755	24,214	44,258	36,020	MNR
EBIDA margin (%)	N.A.	12.50	13.60	23.90	25.30	14.40
Excess revenues over expenses ($000s)	N.A.	1,272	1,839	22,309	14,725	MNR
Excess income margin (%)	N.A.	0.70	1.00	12.10	10.40	5.30
Operating lease expense	N.A.	2,692	3,316	2,356	2,574	MNR
Lease-adjusted annual debt service coverage (x)	N.A.	1.25	1.27	2.63	2.06	MNR
Lease-adjusted annual debt service burden (% total revenues)	N.A.	11.10	12.10	9.60	13.20	MNR
Lease-adjusted annual debt service burden (% total expenses)	N.A.	11.20	12.30	10.90	14.70	MNR
MADS ($000s)	N.A.	N.A.	16,635	11,229	12,821	2,135
Lease-adjusted MADS coverage (x)	N.A.	N.A.	1.65	4.15	3.01	1.80
Lease-adjusted MADS burden (% total revenues)	N.A.	N.A.	9.30	6.10	9.00	8.70
Pro forma MADS ($000s)	N.A.	15,143	N.A.	16,942	14,068	MNR
Pro forma lease-adjusted MADS coverage (x)	N.A.	1.75	N.A.	2.75	2.74	MNR
Pro forma lease-adjusted MADS burden (% total revenues)	N.A.	8.00	N.A.	9.20	9.90	MNR
Total revenue per student ($)	N.A.	14,985	14,604	15,898	13,005	MNR
Balance sheet metrics						
Days' cash on hand	N.A.	149.40	160.67	139.36	171.81	185.20
Total long-term debt ($000s)	N.A.	283,050	299,475	223,721	233,510	MNR
Unrestricted reserves to debt (%)	N.A.	26.20	24.80	26.30	23.50	35.00
Unrestricted net assets as % of expenses	N.A.	71.70	74.60	80.90	86.20	57.20
Debt to capitalization (%)	N.A.	65.50	70.00	63.70	69.60	73.00
Debt per student ($)	N.A.	19,272	23,882	18,626	21,362	11,995
Pro forma metrics						
Pro forma long-term debt ($000s)	N.A.	271,255	299,475	268,653	237,129	MNR
Pro forma debt to capitalization (%)	N.A.	68.00	71.00	68.00	70.00	MNR
Pro forma debt per student ($)	N.A.	21,347	24,553	23,072	21,693	MNR

Alliance For College-Ready Public Schools (Consolidated) - GCP, Calif.: Enterprise And Financial Statistics (cont.)

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. Lease-adjusted MADS coverage = (Net revenue available for debt service + operating lease expense) / (MADS + operating lease expense)