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California School Finance Authority Aspire Public Schools; Charter Schools

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Long Term Rating	BBB/Stable	Affirmed

Rationale

S&P Global Ratings affirmed its 'BBB' rating on the California School Finance Authority's series 2015 and series 2016 charter school revenue bonds, issued for the Aspire Public Schools-Obligated Group. The outlook is stable.

Operations from 13 of Aspire's 40 schools secure the bonds. These schools operate under the parent organization, Aspire Public Schools. Based on our "Group Rating Methodology," published Nov. 19, 2013, the rating analysis encompasses the entire Aspire organization. The 'BBB' rating is based on our view of Aspire's group credit profile (GCP) of 'bbb+' and the highly strategic status of the obligated schools, given that several of these schools are some of the oldest and most successful schools. We view the obligated group as important to the organization, with parent support of the obligated group as likely in the event of operating difficulties, but the obligated group as limited to a highly strategic status, given that it represents only 36% of total organization headcount. Under the methodology, a highly strategic group is rated one notch lower than the GCP, unless the standalone credit profile (SACP) of the obligated group is equal to, or higher than, the GCP. The rating applies only to the series 2015 and 2016 bonds--not to Aspire Public Schools as an organization. Financial metrics cited in this report (unless otherwise indicated) reflect those of the entire Aspire organization.

We assessed Aspire Public Schools' enterprise profile as strong, characterized by healthy demand; a diverse network, with 40 schools operating under 14 different authorizer jurisdictions spread out across California and Tennessee; and a solid management team that has demonstrated successful maneuvering of the challenges involved with the charter authorization process. We assessed Aspire Schools' financial profile as adequate, with an abundant revenue base, robust operating margins generating substantial maximum annual debt service (MADS) coverage, and a debt profile that we view as in line with the rating level. We believe that these combined credit factors lead to an indicative group credit profile of 'bbb' for Aspire Public Schools. In our opinion, the 'bbb+' GCP (and final rating of 'BBB' on the bonds) better reflects Aspire's very large enrollment--over 16,000 students are enrolled at 40 individually chartered campuses under 14 separate authorizers--which limits exposure to any one charter.

More specifically, factors supporting the rating include:

- The sophisticated and experienced management team that operates the schools, though there are transitions in progress in senior positions, which we anticipate should occur smoothly given the institutional knowledge of long-tenured individuals who remain with the organization;

- Aspire's good demand, demonstrated by enrollment increases during the past several years; and
- The school's average but acceptable MADS coverage of 1.35x in fiscal 2017, though we anticipate much lower MADS coverage based on fiscal 2018 actuals.

Partially offsetting the rating are:

- Aspire's demonstrated appetite for expansion, which inherently presents some uncertainties and risks, with current plans to focus on building out existing schools and feeder patterns in California and opening one school per year in Memphis over the next four years;
- The school's decline in cash position, with a slim 75 days' cash on hand in fiscal 2017; and
- The potential that various charters could be revoked or not be renewed due to potential noncompliance with the terms of the charter (as with all charter schools) prior to the bonds' final maturity.

The series 2015 and 2016 bonds are secured by revenue of the 13 schools in the obligated group. The series 2015 and 2016 bonds make up the majority of Aspire's debt, although there are other short-term and state-funded facilities debt outstanding. Management does not plan to issue additional debt secured by the revenue of the schools in the obligated group in the near term. The borrower, College for Certain Inc., is a limited liability company and a component unit of Aspire Public Schools. The sole member is a California nonprofit public benefit corporation that was formed as a support organization for Aspire charter schools. The borrower is a single-purpose entity with no assets other than the facilities. The borrower has entered into lease agreements with each of the schools in the obligated group. The debt service coverage (DSC) and days' cash covenants are in line with those of other charter school transactions and are listed below. The base rent coverage calculation is more unique to the series 2015 and 2016 bonds. Management is in compliance with these covenants currently and expects to remain well above these thresholds:

- Base rent coverage ratio for each school of at least 1.1x, allowing for some support from the parent, if necessary;
- Days' cash on hand of at least 30; and
- DSC of the obligated group of at least 1.0x.

Aspire Public Schools operate 40 schools and serves over 16,000 children in California and Tennessee. The system was founded in 1998 and was the nation's first charter management organization. Until 2013, all of its schools were in California, spread fairly evenly among the Central Valley, the Bay Area, and Los Angeles. In 2013, it opened its first three schools in Memphis to address the lack of school choice in Tennessee. Its schools in California have a long history of strong academic performance, lean management, and serving low-income students.

Within the obligated group, River Oaks Charter School and Benjamin Holt College Preparatory Academy (Ben Holt) opened in 2001 and 2003, respectively, in the Central Valley. Aspire also opened a third school near those campuses--Ben Holt Middle School--to enable the schools to expand their middle and high school grades. The other obligated schools include: Aspire Golden State College Prep Academy, Aspire Junior Collegiate, Aspire Titan Academy, Aspire Pacific Academy, Aspire Langston Hughes, Aspire Port City Academy, Aspire Alexander Twilight College Preparatory and Secondary Academy, Aspire East Palo Alto Phoenix Academy, and Aspire Lionel Wilson College Preparatory Academy. There are several schools in three regions--Central Valley, Los Angeles, and the Bay

Area--which opened between 2006 and 2015. The combined enrollment at the obligated schools is about 5,966 currently and could grow to about 6,300 by 2022.

Outlook

The stable outlook reflects our view that Aspire will perform at a modestly healthy operational level and attract sufficient students such that it continues to generate lease-adjusted MADS coverage around fiscal 2017 levels or better starting in fiscal 2019. We also anticipate the organization will at least maintain its current level of days' cash on hand and its robust enterprise profile.

Downside scenario

We could consider a negative rating action if financial performance in fiscal 2019 does not improve significantly to positive operations after the expected deficits (unaudited) in fiscal 2018 or if days' cash on hand do not improve from current levels.

Upside scenario

A positive rating or outlook change would be based on significant cash increases and sustained stronger MADS coverage at the obligated group, as well as strengthening at the parent level.

Enterprise Profile

Economic fundamentals

Aspire has 36 schools located across California and four schools located in Tennessee. Eleven schools are in Los Angeles County, which is the most populous county in the U.S. The county's minor population is very healthy, at about 3 million with projections indicating a decline of 6.4% through 2023.

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 Aspire's enrollment and demand profile as sound, supported by its large enrollment, steady growth, and modest wait lists. Aspire's mission is to serve low-income populations, and nearly all of its schools give priority to students who qualify for free and reduced-price lunch. Most of the schools outperform their local districts in state tests, and those that don't have scores close to the state average. The Aspire schools have historically had a good reputation for academic quality, having earned state-level awards as well as a U.S. Department of Education award for educator effectiveness in 2012, which came with $27.8 million in grant funding. Although there are other local charter schools, Aspire's ability to increase enrollment consistently demonstrates a solid demand position, which we do not expect to change despite the competitive environment in California.

The schools in the obligated group have six charter school authorizers: Lodi Unified School District, San Juan Unified School District, Oakland Unified School District, Ravenswood City School District, Stockton Unified School District, and Los Angeles Unified School District (LAUSD). Aspire schools outside of the obligated group are additionally authorized by six other local education agencies throughout California, and the Achievement School District and Shelby County Schools in Tennessee. Management reports positive relationships with each authorizer and expects the renewal of each school's charter upon expiration. We view the overall organization's charter standings with its authorizers as sufficient, and based on our contact with a portion of the authorizers, there are no known concerns at this time. Aspire Schools has held its charter with the Lodi Unified School District for over 15 years and its charter with the Oakland Unified school district for over 14 years, representing the two longest-standing charters in the obligated group.

In our view, the statutory framework could negatively affect Aspire's ability to meet debt service due to its dependence on LAUSD as an authorizer for several of its schools. In 2014, LAUSD rejected renewal of two Aspire schools not within the obligated group; following a successful appeal by Aspire, these two schools were then chartered by the Los Angeles County Office of Education. Despite the good outcome, the risks of the authorization process remains, and in our view, there is a critical mass of students still under LAUSD's jurisdiction that could affect the overall credit profile should those charters face issues. Our view of these risks are somewhat offset by the staggered renewal terms.

Funding under the Local Control Funding Formula began in 2013-2014 and has been favorable since, with large jumps in per-pupil funding due to gap funding along with a robust state economy that has generated high revenue and local property taxes that dictate minimum funding level increases. However, we anticipate that the significant one-time state funds received in the previous fiscal years will cease, moderating per-pupil revenue growth in the near term.

Management and governance

Management of the Aspire Schools is quite centralized, with an executive team made up of the CEO, the chief financial officer, the chief operating officer, chief people officer, a new chief academic officer, and a new chief schools officer who oversees four area superintendents. The chief of staff serves as the interim CEO starting Aug. 1, 2018 with a search for a permanent CEO expected to conclude by spring 2019. The previous CFO left Aspire in March and a replacement is expected start in September 2018. Other members of the management team have long tenures with Aspire, and we expect that the good financial policies and practices will continue. In our view, the board is also well diversified. A 10-member board governs all schools centrally, and parent councils support each school. The board is organized through committees, and members have a mix of board tenure and career experience.

Financial Profile

Financial performance

After a period of robust state revenue contributing to high margins and buildup of reserves in fiscal 2014 through 2016 with 11%-12% margins, Aspire spent some of its reserves to improve programs in fiscals 2017 and 2018. Coverage in fiscal 2017 was 1.35x. The obligated group's coverage of the series 2015 and 2016 bonds is 1.25x in fiscal 2017. Based on fiscal 2018 year-end estimates provided by management, a 3.4% deficit is projected for the organization, which would produce less than 1.00x coverage. We understand management intends to stop reserve spending in fiscal 2019, and has budgeted for a $2.8 million or negative 1.2% deficit, which we expect could improve throughout the year to positive dependent on conservative budgeting practices.

Liquidity and financial flexibility

While cash levels had been acceptable in fiscal years 2014 through 2016 when it reached 103 days' cash on hand, it declined significantly in fiscal 2017 to 74 days' cash on hand. $10 million was recorded as investments, primarily in government bonds; we understand these amounts are available if needed and not restricted. The cash level for the obligated schools was 111 days' cash on hand in fiscal 2016 and declined to 80 days' cash on hand in fiscal 2017 after spending on programs. We expect cash levels to stay level or increase modestly for fiscals 2018 and 2019.

Debt burden

Aspire's lease-adjusted MADS burden is moderate for the rating, at 6% of operating revenue in fiscal 2017. We expect this will remain roughly the same as the organization expands, adding on additional debt or leases, offset by expectation of a growing revenue base.

Total series 2015 and 2016 bonds outstanding is $112 million. In addition, there is roughly $28 million in additional loans held by Aspire Public Schools. Based on past two years of monthly cash flows provided by management, liquidity is sufficient to cover an acceleration on these loans.

Financial policies

Aspire Public Schools meets standard annual disclosure requirements. The financial policies assessment reflects our opinion that, despite areas of risk, the organizations' overall financial policies are not likely to hamper their ability to pay debt service. Our analysis of financial policies includes a review of the organizations' 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.

Aspire Public Schools, Calif.: Enterprise And Financial Statistics

	--Fiscal year ended June 30--					--Medians for 'BBB+'/'BBB' rated charter schools--
Enrollment	**2018**	**2017**	**2016**	**2015**	**2014**	**2017**
Total headcount	16,407	15,830	15,365	14,728	13,005	2,395
Total waiting list	9,351	8,838	5,605	6,392	4,928	MNR
Waiting list as % of enrollment	57.00	55.80	36.50	43.40	37.90	42.60
Financial performance						
Total revenues ($000s)	N.A.	207,950	205,734	174,377	150,900	23,549
Total expenses ($000s)	N.A.	207,083	180,746	154,403	132,698	MNR
EBIDA ($000s)	N.A.	12,615	37,250	32,355	30,047	MNR
EBIDA margin (%)	N.A.	6.10	18.10	18.60	19.90	14.40
Excess revenues over expenses ($000s)	N.A.	867	24,988	19,974	18,202	MNR
Excess income margin (%)	N.A.	0.40	12.10	11.50	12.10	5.30
Operating lease expense	N.A.	4,166	3,466	3,481	3,367	MNR
Lease-adjusted annual debt service coverage (x)	N.A.	1.54	2.54	2.23	2.21	MNR
Lease-adjusted annual debt service burden (% total revenues)	N.A.	5.20	7.80	9.20	10.00	MNR
Lease-adjusted annual debt service burden (% total expenses)	N.A.	5.30	8.90	10.40	11.40	MNR
MADS ($000s)	N.A.	12,438	13,013	13,013	13,013	2,135
Lease-adjusted MADS coverage (x)	N.A.	1.35	3.13	2.75	2.57	1.80
Lease-adjusted MADS burden (% total revenues)	N.A.	6.00	6.30	7.50	8.60	8.70
Lease-adjusted MADS burden (% total expenses)	N.A.	6.00	7.20	8.40	9.80	MNR
Total revenue per student ($)	N.A.	13,136	13,390	11,840	11,603	MNR
Balance sheet metrics						
Days' cash on hand	N.A.	74.25	102.95	97.02	97.19	185.20
Total long-term debt ($000s)	N.A.	131,154	129,695	132,334	135,441	MNR
Unrestricted reserves to debt (%)	N.A.	28.80	35.00	29.90	25.00	35.00
Unrestricted net assets as % of expenses	N.A.	38.00	45.00	40.10	34.90	57.20
Debt to capitalization (%)	N.A.	64.60	63.70	68.40	74.90	73.00
Debt per student ($)	N.A.	8,771	8,976	8,785	10,207	11,995

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)