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Charter Schools Find Smarter Way to Borrow

Life School in Texas tapped the credit markets to fund the construction of a new campus in Waxahachie, near the one above. Charter schools, typically seen as among the riskiest municipal borrowers, are finding the credit markets friendlier amid a broader rally in municipal bonds. MEI-CHUN JAU FOR THE WALL STREET JOURNAL

By AARON KURILOFF
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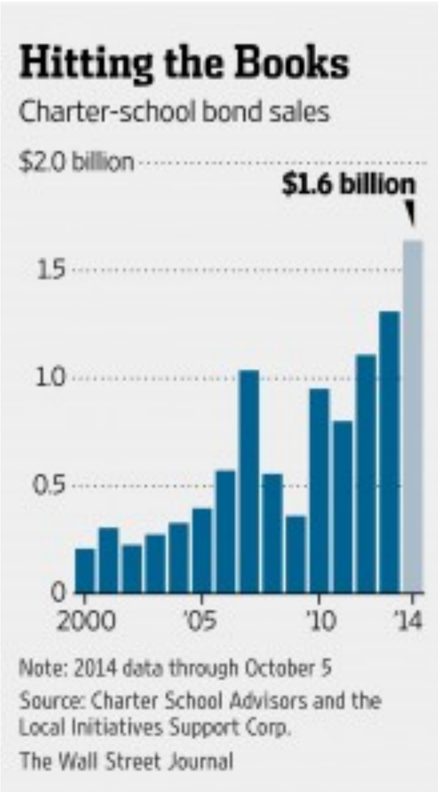
An extended rally in municipal bonds is helping Gloria Bonilla-Santiago grow the Camden, N.J., charter-school network she founded in 1997.

Although charter schools are among the riskiest municipal borrowers, and the city of Camden struggles with poverty and crime, Dr. Bonilla-Santiago was able to raise $10 million in a September bond sale. The money will enable her LEAP Academy University Charter School to expand its campus into the Wilson Building, a 12-story downtown landmark, adding a new cafeteria, fitness center, science labs and a health clinic.

“It’s a big responsibility, but there was an opportunity in the market to be able to sell bonds at a good rate,” Dr. Bonilla-Santiago said.

The school is paying a rate of 6.3% on longer-term debt. Comparable borrowing costs in 2009 were about 7.6%, according to the Local Initiatives Support Corp., which advises charter schools on finances.

Bonds issued by U.S. cities and states have rallied this year, posting their longest string of monthly gains in more than two decades while outpacing gains in corporate and U.S. Treasury debt. Municipal bonds have returned 8.71% through Dec. 26, according to Barclays PLC. Total return includes price increases and interest payments.



The rally in the $3.6 trillion market is pushing down borrowing costs for scores of municipalities, including issuers of lower-rated debt. Puerto Rico, which is rated below investment grade due to its heavy debt burden, sold $3.5 billion of bonds in March. In October, the operator of a struggling toll road in California issued $1.4 billion. Investors' rising appetite for muni bonds is a boost for charters, which are typically nonprofit, publicly funded and run independently from local school districts. Charter schools, which educate about 2.6 million students in the U.S., issued about $1.64 billion of debt this year through Oct. 5, more than the record volumes from all of last year and the year before, according to a report by Charter School Advisors and the LISC.

The ramp-up in charter schools' debt sales comes as mainstay municipal issuers cut back amid postrecession belt-tightening by public officials. They are attracting yield-hungry investors who have pushed into riskier debt in search of better returns amid low interest rates.

Investors consider charter-school bonds to be riskier than conventional school-district debt because charter schools' primary funding is per-student payments from the state rather than local property taxes. That makes it hard for charters to finance buildings or renovations without tapping outside sources like donors or the bond market.

Charter-school bonds are the seventh-most likely sector to miss debt payments, out of 33, according to data from Municipal Market Advisors, a research firm based in Concord, Mass. About 1.37% of outstanding charter bonds, including both rated and unrated debt, have defaulted. That compares with an average of .03% for all rated bonds over the past five years, according to a report by Moody's Investors Service. Charter schools have issued more than $10 billion in bonds since 1998.

John Miller, co-head of fixed income at Nuveen Asset Management LLC, said he has been "pretty aggressive" about adding charter-school bonds, and now holds about $1.4 billion, the majority of which are in the Nuveen High Yield Municipal Bond Fund, which has returned more than 18% this year. Safely investing in the sector requires analysis and legwork, even visiting the schools, he said. That means the market doesn't necessarily price the bonds efficiently, creating an opportunity to find bargains.

"I've heard people say 'I can't get my arms around the idiosyncratic risk here,'" Mr. Miller said. "But there are returns to be had for actually doing that."

Other factors are driving charter-school bond sales.

Life School, near Dallas, was stuck paying relatively high rates until this year, when Texas agreed to guarantee its bonds—and those of other investment-grade charters—through the $37.7 billion Permanent School Fund, the nation's largest education endowment. Created with a $2 million grant in 1854, the fund backs about $55.2 billion of Texas school debt with money from investments such as state land, providing districts with the equivalent of a triple-A rating and access to lower-cost borrowing.

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Scott Fuller, Life School's chief of staff, said that guarantee saved about $13 million on building a new high school in Waxahachie.

"To put $13 million back into the classroom for us—it's a game changer," he said.
Life School estimates a state guarantee saved it $13 million on building a new Waxahachie, Texas, campus.

Six Texas charter-school operators have now accessed the guarantee to back about $273 million in debt, according to the Texas Charter Schools Association.

"Finding and providing facilities is always challenge No. 1 throughout the state, so being included in the Permanent School Fund and having the full faith and credit of the state of Texas and the triple-A rating to back those bonds has been a huge boon to charter schools," said David Dunn, executive director of the group.

Meanwhile, the growth of charters poses an increasing risk for public school systems in cities such as Philadelphia, Cleveland and St. Louis that compete with them for students and state money, according to a report by Moody's.

Students' flight to charters has helped reduce the Philadelphia district's underlying credit rating to junk, which is defined as below BBB- or the equivalent, though investors are protected by a state program that can withhold district funds for bondholders, Moody's said.

In Camden, workers are renovating the Wilson Building, which is scheduled to open this summer. The school hasn't always had an easy path financially, according to Dr. Bonilla-Santiago, who is also a professor at Rutgers University. LEAP lost its tax-exempt status in 2010 after the school got bad advice on its paperwork-filing requirements, she said. The Internal Revenue Service restored the exemption after an appeal. The recent bond sale was rated BB- by Standard & Poor's Ratings Services.

The process of accessing the bond market, such as receiving a credit rating, helped the school improve its financial management, Dr. Bonilla-Santiago said. And as LEAP has grown, its buildings and students have helped breathe new life in the neighborhood around Camden's Cooper Street, she said.

"The school has to be run like a business," she said. "It has to be accountable. You have to have yearly audits. You have to build credit and you have to have the right kind of reputation. And that takes time."

Read at http://www.wsj.com/articles/charter-schools-find-smarter-way-to-borrow-1419820840