Bond Case Briefs

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Record Charter-School Defaults Underscored by Albany Closings.

(Bloomberg) — Charter schools are selling a record amount of municipal debt. For investors, the challenge is that defaults by the publicly funded, privately run institutions have also never been higher.

Underscoring the risk to bondholders such as Nuveen Asset Management, two New York schools are set to shut at the end of this school year after their charters were revoked this month for academic shortcomings. The closings represent a default under terms of the $15 million bond deal that financed the land acquisition and construction of Brighter Choice's middle schools for boys and girls, which opened in 2010 under the same roof.

While charter schools are gaining popularity across the U.S. as an alternative to local systems, their default rate reached an all-time high last year of 5 percent of outstanding issues, according to a biannual study by the New York-based Local Initiatives Support Corp. That's up from 3.8 percent in 2012.

"Charter schools not only wrestle with financial operations and student demand, but also with maintaining their charter, which is highly dependent on their educational outcomes," said Matt Fabian, a partner at Concord, Massachusetts-based research firm Municipal Market Analytics.

Record Haul

The schools began tapping the $3.5 trillion municipal market in 1998 and have issued about $10.4 billion of bonds in 800 transactions, according to Local Initiatives Support Corp., a community-development organization. Last year's tally of about $2 billion was the most yet, according to Municipal Market Analytics.

While accounting for less than 1 percent of sales, the schools are gaining stature in the tax-exempt market as enrollment climbs. The institutions enrolled 4.6 percent of U.S. public school students in 2013, up from 2.1 percent a decade ago, according to the National Center for Education Statistics.

For investors who can stomach the risk, the securities offer a way to pad returns.

Brighter Choice obligations sold for the middle schools and maturing in July 2042 priced three years ago to yield 7.5 percent, data compiled by Bloomberg show. That was about 4 percentage points above benchmark munis.

Fitch Ratings cut the debt March 20 to C, 11 steps below investment grade. The tax-exempt bonds were sold through a Phoenix industrial development authority.

Securities sold for Brighter Choice's elementary schools and that mature in April 2020 traded last month at about par, to yield 4.75 percent, or about 4.2 percentage points above benchmark debt, Bloomberg data show. Fitch grades the bonds B+, seven steps above the middle-school debt.

Bond Compliance

The State University of New York Charter Schools Institute's board of directors, which oversees authorization, voted not to renew the middle schools' charters this month, even as the organization reported compliance with bond covenants, according to Mahati Tonk, the institute's director of charter-school information. Brighter Choice's two elementary schools had their charters renewed last week.

In the 2013-2014 year 53.8 percent of the middle school's 8th-grade boys scored at or above state-mandated proficiency levels for science, short of the 75 percent benchmark set by the SUNY authority. The boys' school ranked in the 23rd percentile statewide in math.

Falling Short

"They knew that they were falling far from the academic expectations and were in jeopardy of losing their renewal," said Susie Miller Barker, executive director at the SUNY institute in Albany.

The finances were on more solid footing. As of the end of December, Brighter Choice reported 76.42 days of cash on hand, almost quadruple the required amount, bond filings show. The debt-service coverage ratio of about 1.3 exceeded the required 1.10 figure, according to the filings.

Calls to the Brighter Choice schools were referred to Lynea Woody, vice president of improvement at the Albany Charter School Network, which runs them. The organization runs Brighter Choice. Woody said she didn't have an immediate comment.

Bondholders will try to sell the schoolhouse to recoup their investment, said John Miller, who oversees $100 billion of munis as co-head of fixed income at Nuveen in Chicago. The company has invested in more than 250 schools, Miller said.

"Recovery rates are all over the place," he said. "In some cases we've been in the 60 to 70 percent range for the rare foreclosure."

Nuveen is the biggest holder of the Brighter Choice middle-school debt, data compiled by Bloomberg show.

Students' Fate

The majority of the 400 students attending the middle schools will look to switch to the Albany district, which doesn't have room, said Ron Lesko, a district spokesman.

"We have our own enrollment growth that's been fairly significant in recent years," Lesko said. "We're already at max capacity."

To accommodate the influx, the district may buy the Brighter Choice building, keep the students there and hire staff, Lesko said.

"We want to come to some sort of reasonable financial arrangement," Lesko said. "But if that's not possible and we can't, we have another building in mind."

The alternative site is available for a reason: It housed another failed charter school that closed in 2010, Lesko said.

The building had about $20 million in obligations attached to it and the district bought it for $2.5

million in 2012.

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