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Walton Family Backs Bond-Market Experiment for Charter Schools.

- **Non-profit is floating first bond for revolving loan fund**
- **The loans would cut reliance on high-yield muni-bond market**

Anand Kesavan spent more than a decade as a public finance banker working with state loan funds for clean water projects before a two-year stint as chief financial officer at KIPP Austin, a network of 10 charter schools in Texas's capital.

Now, he's heading a non-profit backed by the family of Walmart Inc. founder Sam Walton that's experimenting with a novel way to cut the cost of financing charter schools. On Wednesday, his Equitable School Revolving Fund will sell the first bonds ever used to finance a loan pool for such experimental schools, creating a potentially cheaper way for them to raise funds than selling higher interest-rate bonds on their own.

"Bringing down costs for schools is just as important as trying to bring up revenues," said Kesavan, chief executive officer of the Equitable Facilities Fund, the non-profit parent of the ESRF. "One of those way is to borrow at better terms."

Bond sales by charter schools have grown five-fold in the last decade to $3 billion, reflecting rising enrollment in the taxpayer-funded schools, which are independently run and provide an alternative for parents of children in poorly performing districts. The debt is among the riskiest in the municipal market because of the chance that students won't enroll or weak performance will cause them to close. Most individual charter-school securities aren't rated or carry junk ratings, causing investors to demand higher yields.

The fund, which received a $200 million grant from the Walton Family Foundation to start making loans, plans to issue about $110 million bonds through the Arizona Industrial Development Authority and the California Infrastructure and Economic Development Bank. Proceeds of the sale managed by Royal Bank of Canada will finance or reimburse $158.5 million of loans to 11 charter school operators in seven states.

Water-Fund Inspired

The ESRF was inspired by state revolving-long funds for water projects, which received initial capital from federal grants in the 1980s, said Kesavan, a former banker with UBS AG and Siebert, Brandford Shank & Co. Before those funds, municipalities had to pay higher interest rates to finance water and sewer infrastructure because they were borrowing on their own.

Like securities issued to finance water revolving funds, the ESRF will allow investors to diversify risk, while also providing greater scale and liquidity, Kesavan said.

Six of the charter school operators participating in the loan program have S&P ratings of BBB- or BBB. Three are rated BB or BB+ and two are not rated. The operators run 41 schools that are

pledged to secure the bonds.

The new securities received an A rating by S&P Global Ratings Inc. because the $277 million of charter school loan repayments is greater than the $213 million debt service. As loans are repaid, the ESRF will use the money to make new loans. The fund will be able to withstand the default on 26% of its loans, assuming a 0% recovery, according to ESRF.

By contrast, a portfolio manager that had held individual charter school bonds would face the risk of losses immediately. Less than 4% of charter school bonds have defaulted, according to a 2017 study by NewOak Fundamental Credit.

“The premise of this deal is that investors can play in the charter school space but benefit from an A rating,” said Dora Lee, director of research at Belle Haven Investments. “However, it is hard for investors to be confident that that rating will be stable given that it’s an unproven loan fund and there’s going to be a lot more leverage coming down the pike.”

In addition to Wednesday’s deal, the ESRF plans to issue another $130 million of bonds in 2020 and $170 million in 2021. A minimum $600 million in school loans will be pledged to the $400 million in bonds.

ESRF spends six to nine months analyzing the charter schools applying for loans, scrutinizing factors like academic and financial performance, real estate, market position, regulatory environment and operating history.

The fund will monitor loans and can provide technical assistance, early intervention and remediation if the schools run into trouble.

“We can differentiate between the schools that are of good quality versus those that that aren’t” Kesavan said. “That’s the value that we offer to investors.”

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