THE BOND BUYER

Arizona IDA preps $230M social bond for Equitable School Revolving Fund

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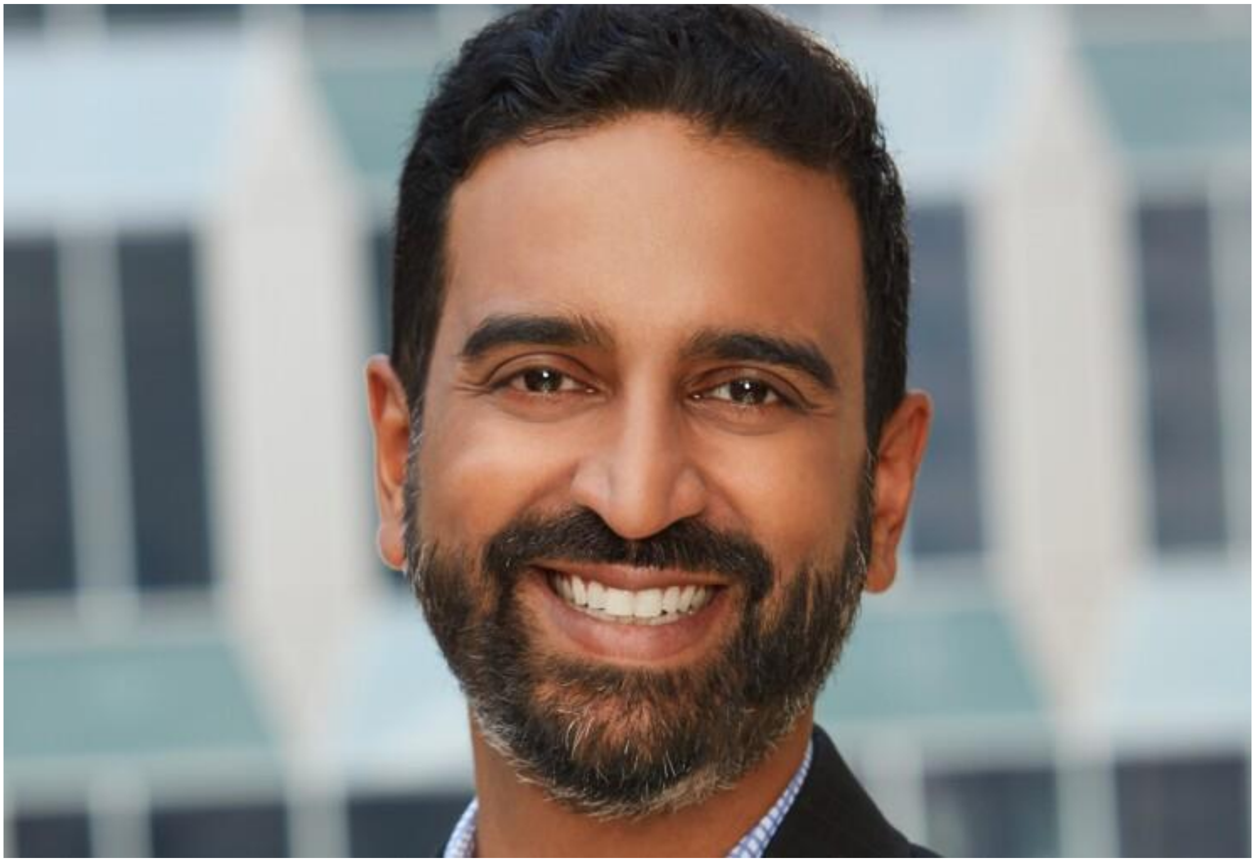
Published

November 27, 2023, 1:24 p.m. EST

The Arizona Industrial Development Authority as conduit issuer is set to offer a $230 million social bond next week to support a variety of high-performing public charter schools across the United States.

Siebert Williams Shank as senior manager is slated to price the Series 2023A senior National Charter School revolving loan fund social revenue bonds on Dec. 5 for the Equitable School Revolving Fund LLC.

Co-managers are RBC Capital Markets, Goldman Sachs, Stephens, Morgan Stanley and PNC Capital Markets.



"Growing waitlists show us that families want more high-quality options, and it's one of the reasons EFF portfolio schools have overperformed, with zero defaults in five years," said CEO Anand Kesavan.

"This is our fifth annual bond issuance," Equitable Facilities Fund founder and CEO Anand Kesavan told The Bond Buyer.

The EFF, a 501(c)(3) non-profit corporation that was created to make low-interest loans to high-performing public charter schools, is the only member of the Equitable School Revolving Fund.

"We have a cadence where we issue debt every year, usually in the second half of the year, to reimburse ourselves for loans we have made during the year," Kesavan said.

The deal is tentatively structured as serials, ranging from Nov. 1, 2024, to Nov. 1, 2053.

The bonds are rated A with a positive outlook by S&P Global Ratings.

"The rating reflects the steady growth of ESRF in a manner consistent with its sole function to further the charitable purpose of its sole member, the nonprofit 501(c)(3) Equitable Facilities Fund: to make loans and provide financial assistance to charter schools," S&P said in its rating report, in which it affirmed outstanding ESRF bonds issued by AZIDA, the California Infrastructure and Economic Development Bank, the Massachusetts Development Finance Agency, and the City of Albany Capital Resource Corp. in New York.

Proceeds will be used to make new loans and reimburse loans already made within the ESRF. After the sale, the amount of senior and subordinate ESRF bonds outstanding will be around $1 billion.

The EFF was established in 2017 and since then has provided more than $1 billion in loans to over 170 charter schools in 20 states. These loans provide these schools with access to low-cost funding for debt refinancing and finance the construction of new buildings or improvements to existing facilities.

Kesavan said the EFF has an open pooled loan structure, "where all the loans are pooled together into one big lump. We capitalize that with a lot of equity and by doing that we have achieved an A rating with a positive outlook."

A total of 77 loans to 70 charter schools and obligated groups with a loan balance of roughly $1.3 billion will be pledged to about $1 billion of senior-lien bonds outstanding issued when the Series 2023 bonds are closed on Dec. 19.

ESRF has had a strong track record over the past five years that it has been issuing bonds, said David Stinfil, managing director at Siebert Williams Shank.

"For five years they have had zero defaults and have grown appropriately at a rapid pace and they expect to grow into the future," Stinfil told The Bond Buyer.

"In communities across the country with few or no quality educational options, seats at public charter schools are an in-demand asset," Kesavan said. "Growing waitlists show us that families want more high-quality options, and it's one of the reasons EFF portfolio schools have overperformed, with zero defaults in five years."

EFF said its low-cost loans have saved educational institutions an estimated $250 million over the last five years, allowing them to take money that would have gone to high-interest loan payments and put it into classrooms to help students.

Through philanthropy, EFF has so far raised over $350 million to support the fund's credit structure. It said it is currently raising an additional round of funding and aims to invest over $3 billion into charter schools, serving more than 150,000 students, by 2028.

Combined with the pledged excess revenues from previous loan repayments of about $30 million and a debt service reserve of $25 million, these aggregate revenues provide enough overcollateralization to provide credit support for the rating, according to S&P.

S&P said its positive outlook reflects a trend of ongoing diversification of the loan portfolio as loans are added to the pool each year.

"The growth strengthens the pool's ability to withstand default stresses, and reduces concentration geographically, among the largest borrowers. As the program grows, we expect the pool will maintain sufficient debt coverage and collateral levels that will enable it to absorb potential defaults," S&P said.

The A rating could be raised by one notch "if the program continues generating additional loan demand that increases the pool's asset diversity, while exhibiting solid operating performance with no delinquencies or defaults and sustained strength of the loss coverage score," the rating agency said.

"In addition, we expect that as loans are added to the portfolio, the credit quality of individual borrowers will generally be in line with or better than that of the overall portfolio, and that the credit quality of existing borrowers will remain stable," S&P said.

S&P said it could revise its positive outlook to stable or lower "if the pledged loan portfolio begins to experience payment delinquencies or defaults even if there are sufficient funds to make all required bondholder payments."

It would also view negatively "a weakening of the overall pledged loan portfolio by way of increasing leverage or adding loans with a longer weighted-average maturity or deferred principal payments, loans to a portfolio of borrowers that are materially lower in credit quality, or loans that create undue portfolio concentration in one or several states," S&P said.

In October, HilltopSecurities released a report saying it has a stable outlook for charter schools into 2024.

"This outlook reflects the relative maturation of the sector that now educates more than 3.7 million students in almost 8,000 campuses across the United States," the report said.

"Despite our stable outlook, we recognize that there are some headwinds reflecting capital and operational pressures that the schools will face over the medium term," the report said.

Kesavan said this deal is also a chance for investors to pick up some yield with a strong credit.

"In my opinion, a pooled fund of public schools with such a high default tolerance, especially in a time of recession, is a better investment than most munis, even tax-exempts," Kesavan said.

He said AZIDA, as conduit issuer, was a good fit for the deal and has a fairly open policy that allows for out-of-state issuers.

"Having a single conduit helps with costs, keeping costs down," he said. "AZIDA is a very friendly issuer to work with — legally, operationally and financially."

AZIDA has not been with its controversies, including the bankruptcy of conduit borrower Legacy Cares, along with other defaults among its conduit issues, subjecting it to increased scrutiny.

In March, Arizona Gov. Katie Hobbs informed Executive Director Dirk Swift the agency must disclose details about borrowers, including past projects and experience, existing financings, past defaults, debt-to-income ratio over the past 12 months, and business plans.

The agency was asked to direct its bond issuances to certain priority areas listed by the governor that included affordable housing, broadband infrastructure, and renewable energy.

AZIDA was also told that each Tax Equity and Fiscal Responsibility Act submission to the Democratic governor's office must address how the proposed project benefits the state of Arizona, particularly its underserved and historically excluded communities, and how it advances the governor's project priorities.

Only a few Arizona charter schools are included in EFF's closed loan portfolio as of Nov. 20.

AZIDA's counsel on the deal is Kutak Rock LLP; the bond counsel and disclosure counsel to ESRF is Orrick, Herrington & Sutcliffe LLP; and the underwriters counsel is Squire Patton Boggs LLP.

The financial advisor is Lamont Financial Services Corp. The external social bond reviewer is Kestrel Verifiers.