

**CHARTER SCHOOL FACILITIES PROGRAM
2011 LOTTERY FUNDING ROUND
STAFF SUMMARY REPORT – MAY 2015**

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| Applicant/Obligor: | Magnolia Educational and Research Foundation |
| Project School: | Magnolia Science Academy – Santa Ana |
| CDS (County – District – School) Code: | 09-76596-0119537 |
| Proposed Project Location: | 2840 W First Street, Santa Ana, CA |
| Project Type: | New Construction |
| County: | Orange |
| District in which Project is Located: | San Ana Unified School District |
| Charter Authorizer: | California State Board of Education |
| Total OPSC Project Cost: | \$17,413,956 |
| State Apportionment (50% Project Cost): | \$8,706,978 |
| Lump Sum Contribution: | \$0 |
| Total CSFP Financed Amount: | \$8,706,978 |
| Length of CSFP Funding Agreement: | 30 years |
| Assumed Interest Rate: | 3.00% |
| Estimated Annual CSFP Payment: | \$521,674 |
| First Year of Occupancy of New Project: | 2016-17 |

Staff Recommendation: Staff recommends that the California School Finance Authority (CSFA) Board determine that the Magnolia Educational and Research Foundation (MERF), applying on behalf of Magnolia Science Academy – Santa Ana (MSA-SA) formerly Pacific Technology School – Santa Ana, is financially sound for purposes of the CSFP Final Apportionment. This determination as it relates to Final Apportionment is in place for six months and assumes no financial, operational, or legal material findings within this time period. This recommendation is contingent upon MERF electing to have its CSFP payments intercepted at the state level, pursuant to Sections 17199.4 and 17078.57(a)(1)(A) of the Education Code. Staff recommends that the CSFA Board direct staff to notify the Office of Public School Construction (OPSC) and the State Allocation Board regarding this determination.

Background: In June 2011, MERF requested for an advance of \$4,081,395 for Site Acquisition and Design on behalf of MSA-SA (formerly known as Pacific Technology School – Santa Ana) under the Program’s 2011 Lottery Funding Round. MERF received preliminary apportionment for Magnolia Science Academy – San Diego in the amount of \$3,036,122. MERF, on behalf of MSA-SA, is now requesting Final Apportionment. As MERF is the applicant and financial obligor, a discussion of the broader issues with MERF’s financial soundness is included in this report.

Application Highlights: Below staff has highlighted key criteria that was evaluated when conducting the financial soundness review of MERF and MSA-SA. Detailed information is contained in the body of the report.

| Criteria | Comments |
|-------------------------|--|
| Eligibility Criteria | MSA-SA have met all Program eligibility criteria: 1) charter in place; 2) MSA-SA has been in operation for at least two years and 3) MSA-SA is in compliance with the terms of their charter and in good standing with their chartering entity. |
| Demographic Information | <ol style="list-style-type: none"> 1. MSA-SA currently serves 160 students in grades 6-12 in 2014-15. The CSFP project will have capacity for approximately 1,000 students in grades K-12 by 2018-19. Staff notes the aggressive enrollment projections and stress tested the affordability of the project if lower enrollment occurs. 2. MERF currently operates 11 schools with total enrollment of 3,740. Enrollment has grown from 2,608 students in 2010-11. MERF achieved a strong aggregate ADA rate of 97% from 2012-13 through 2014-15. |
| Debt Service Coverage | MERF's projected debt service coverage ratios of 1,054% in 2017-18 and 1,121% in 2018-19 exceed the minimum requirement of 100.0% by a wide margin. However, MERF's ability to meet the minimum debt service coverage is highly dependent on MERF realizing projected enrollment at existing schools (5,040 students by 2017-18 and 5,480 students in 2018-19). MERF's enrollment must be approximately 4,700 students in 2017-18 and 2018-19 to generate projected debt service coverage of at least 100.0%. |
| Other Financial Factors | <ol style="list-style-type: none"> 1. MERF has a relatively small reliance on contributions from private sources. Contributions are projected to constitute only 2% of revenues in 2017-18 and 2018-19. 2. The CSFP payment along with MERF's other projected facilities costs would represent 6% of projected revenues during the first two years of the CSFP payment. 3. Net working capital for 2013-14 of \$7.99 million represented 29.5% of total expenses, which exceeds the preferred minimum of 5.0%. |
| Student Performance | MSA-SA did not meet all AYP in 2012-13 but has shown gradual improvement in API growth scores, achieving scores of 777, 839, and 850 for 2010-11 through 2012-13, respectively. |

Program Eligibility: On October 16, 2014, staff received verification from the California State Board of Education (SBE), MSA-SA charter authorizer, confirming that MSA-SA is: 1) in compliance with the terms of its charter agreement, and 2) is in good standing with its chartering authority. MSA-SA's initial charter was approved on March 12, 2009, was renewed on July 9, 2014, and is effective through June 30, 2019. MSA-SA commenced instructional operations in 2009-10.

Legal Status Questionnaire: Staff reviewed the response to the questions contained in the Legal Status Questionnaire (LSQ) for MSA-SA. MERF answered "Yes" to a LSQ question(s). CSFA staff and counsel have reviewed the facts surrounding the disclosure(s) and have determined that the potential liability does not impact the organization's ability to make its CSFP payments should MERF be granted an apportionment nor a determination of financial soundness.

Project Description: MSA-SA is proposing new construction of a facility at 2840 West 1st Street, Santa Ana, involving construction of a brand new school structure. The new facility will consist of one building housing 29-33 classrooms, and is anticipated for completion for the 2016-17 school year. The school is anticipated to have capacity for 1,020 students in grades K-12. MSA-SA was given a preliminary apportionment of \$17,413,956 of which \$4,081,395 was provided for site acquisition in June 2011.

Organization Information: MSA-SA commenced instructional operations in 2009-10 with 63 students in grades 6 through 8, currently has an enrollment of 160 students in grades 6 through 12, and anticipates expansion to grades K-12. MSA-SA operates as an independent charter school under the auspices of MERF, an educational management organization (EMO) (described below). Through its management staff and Board of Directors, MERF is largely responsible for developing MSA-SA's curriculum, educational priorities, and policies, as well as overseeing the day-to-day operations of the school in conjunction with the school's principal.

Charter Management Organization: Magnolia Educational and Research Foundation is a non-profit organization founded in 1997, becoming a 501(c)(3) entity in 1998. MERF established itself as an organization to provide tutoring prior to establishing its first charter school, Magnolia Science Academy, in 2002. Altogether, MERF oversees eleven charter schools. Eight of the schools, including MSA-1, MSA-2, MSA-3, MSA-4, MSA-5, MSA-6, MSA-7, and MSA-Bell operate in Los Angeles County with LAUSD as the charter authorizer. Among the three schools that operate outside of Los Angeles County, MSA-SD (San Diego County) is authorized by the San Diego Unified School District, MSA-Santa Clara (Santa Clara County) is authorized by the Santa Clara County Office of Education, and MSA-SA (Orange County) is authorized by the State Board of Education.

MERF's educational philosophy and mission are to serve students in grades K-12 by: (1) preparing students to become responsible, educated citizens who have the skills and understanding to participate and work productively in a diverse, multicultural, globally oriented environment; (2) providing a sound educational plan with emphasis on math, science and technology; and (3) providing a rigorous, innovative, and challenging enhanced curriculum with a focus on preparing students to attend the universities of their choice. The prospective student population will likely represent the demographics of the local communities in which the students reside, which are primarily in the metropolitan areas of Los Angeles, and other metropolitan areas throughout the state. MERF specifically targets low-achieving students, English language learners, and students coming from socio-economically disadvantaged families.

Management Experience: The resumes of the school's personnel and the management team demonstrate professional, experienced and qualified individuals serving in key capacities within the organization, as described below.

CMO Management: MERF recently came under public scrutiny, specifically with audits having been performed by the LAUSD Office of the Inspector General and the Joint Legislative Audit Committee (JLAC). Given the findings in the LAUSD audit, LAUSD as the charter authorizer to numerous MERF schools attempted to revoke three MERF charters up for renewal. The LAUSD audit implied MERF had misappropriated public of funds and was on the verge of insolvency. MERF filed a lawsuit against LAUSD to maintain its charters. A subsequent JLAC audit found that LAUSD prematurely moved to revoke MERF charters and did not find sufficient evidence to support the misappropriated public of funds and insolvency claims, rather a lack of certain key financial procedures and policies

that led to questionable MERF expenditures. MERF and LAUSD settled the lawsuit in March 2015 and LAUSD subsequently renewed the three MERF charters.

MERF management has had changes in key positions with a new Chief Executive Officer, Chief Financial Officer and Chief Academic Officer. However, Staff views the changes in management as a positive development for MERF and will allow management to be less reliant on outsourced back-office operators and consultants. As part of the lawsuit settlement with LAUSD, MERF agreed to limit its involvement with the former back-office provider Accord Institute. Going forward, seven new committees have been established by MERF management (Finance, Audit, Governance, Personnel, Academics, Facilities, and Community) to ensure MERF is taking proper measures to preserve liquidity and implementing conservative planning for future growth.

Dr. Caprice Young serves as MERF's Chief Executive Officer. Dr. Young has an extensive history of improving operations at CMOs. She played an integral role in in acquiring charter renewals from LAUSD and bringing stability to MERF's operations. Prior to this role, Dr. Young served in a similar capacity to the Inner City Education Foundation. Dr. Young served as Executive Director of the California Charter School Association from 2003 to 2008. Dr. Young holds an Ed.D. from the University of California Los Angeles, an M.P.A. from University of Southern California, and a B.A. from Yale University, among other various other credentials.

Michelle Hurst-Crumpton serves as MERF's Chief Academic Officer and brings experience from charter and public school management in several states. Prior to this position, she was Assistant Head of School at St. James Episcopal School (2013-2014) and Chief of School Administration & Chief Operating Officer at Algiers Charter School Association (2009-2012). She received a B.S. in Education Administration and a Master of Arts in Curriculum and Instruction from the University of Phoenix, AZ.

Mr. Oswaldo Diaz has served as the CFO of MERF since 2014 and has over 20 years experience in accounting and operations management. Prior to this position, Mr. Diaz served as the Accounting Manager for Nova Academy Charters Schools / Olive Crest (2011-2014). Mr. Diaz holds a B.A. in Accounting from the Universidad Iberoamericana in Mexico City, Mexico and a School Business Management Certificate from the University of Southern California.

Kenya Jackson, the Deputy Chief Academic Officer, will serve as Principal of MSA-SA starting in June 2015. She will be replacing Alberto Ramirez on an interim basis.

Board Experience: MSA-SA are governed by the MERF Board of Directors, which is comprised of the members set forth in the table below.

| Name | Occupation | Term Expiration |
|-------------------------------|--|------------------------|
| Umit Yapanel, Board President | Project Engineer at Audience, Inc. | 2017 |
| Saken Sherkhanov, Secretary | Ph.D. Candidate at UCLA (Chemistry and Biochemistry) | 2018 |
| Mustafa Kaynak, Member | Electronics Engineer | 2017 |
| Diane R. Gonzalez, Member | Community Relations | 2018 |
| Nguyen Huynh | Real Estate Finance | 2016 |
| Remzi Oten | Business (Tech CEO) | 2018 |
| Noel Russel-Uterburger | Comptroller, Independent Contractor | 2017 |

Management Experience for Schools Open Less than Two Years: Not applicable. MERF, as CMO to MSA-SA, has over two years of charter school management experience, and MERF has been involved in the oversight of instructional operations of MSA-SA since its inception in 2009-10.

Student Performance: Pursuant to SB X51 (2010), a designated California State Commission was given the authority to review the Common Core State Standards (Standards), as promulgated by the U.S. Department of Education, and make recommendations to the California Board of Education (Board). This resulted in the Board's adoption of the Standards for purposes of statewide accountability on academic performance. Although this adoption does not directly require all local educational agencies (LEAs) to adopt the standards, pursuant to Education Code, Sections 52060 through 52077, in order for districts to receive funding through LCFF, school districts must submit "Local Control and Accountability Plans (LCAPs) to their respective county offices of education that address State and local educational priorities, and pursuant to Education Code, Section 52060(d)(2), these priorities must include Common Core State Standards.

Assessments based on the Standards are derived from the "Smarter Balanced Assessment System," a test that is planned for initial implementation in spring 2015 for purposes of establishing a baseline for comparing academic performance between schools, and subsequent improvement. As such, the standards do not currently provide metrics for comparing academic performance between schools.

It is noteworthy that as a result of the change to Common Core Standards, CDE's Accountability Progress Reporting has significantly changed. Among the changes are that Growth Academic Performance Index (API) reporting has been temporarily suspended, API rankings will no longer be reported, and Adequate Yearly Progress (AYP) reporting pursuant the No Child Left Behind Act of 2001 is currently limited to public high schools receiving Title 1 funding when they meet specific enrollment criteria. As such, student performance information for purposes of determination financial soundness is limited to API and AYP up until 2012-13 with the exception of specific high schools receiving Title 1 funding. Nonetheless, because of its implications for student enrollment stability and growth, and because staff views student performance as a leading indicator of a charter school's financial position, staff continues to evaluate student performance for purposes of financial soundness, with the limitation of reporting only through 2012-13 at this time.

MSA-SA has four years of reported API and AYP results, allowing staff to assess MSA-SA's academic improvement, as highlighted in the following table.

| Magnolia Science Academy - Santa Ana | FY 2009/10 | FY 2010/11 | FY 2011/12 | FY 2012/13 |
|---|------------|------------|------------|------------|
| ADEQUATE YEARLY PROGRESS (AYP) | | | | |
| Met All AYP Criteria? | Yes | No | Yes | No |
| Criteria Met / Required Criteria | 5 / 5 | 4 / 5 | 13 / 13 | 8 / 9 |
| Met API Indicator for AYP? | Yes | Yes | Yes | Yes |
| Met Graduation Rate? | N/A | N/A | N/A | N/A |
| ACADEMIC PERFORMANCE INDEX (API) | | | | |
| Met Schoolwide Growth Target? | N/A | No | Yes | Yes |
| Met Comparable Improvement Growth Target? | N/A | Yes | Yes | Yes |
| Met Both Schoolwide & CI Growth Targets? | N/A | No | Yes | Yes |
| API Base Statewide Rank (10 = best) | N/A | 8 | 5 | 7 |
| API Base Similar Schools Rank (10 = best) | N/A | N/A | N/A | 7 |
| School's Actual Growth | N/A | -70 | 62 | 12 |
| Similar Schools Median of Actual Growth | N/A | N/A | N/A | N/A |
| Did School's Growth Exceed Median? | N/A | N/A | N/A | N/A |

MSA-SA did not meet all AYP criteria for two of the past four years. However, MSA-SA has met its API growth target during the past two years with an API growth score of 839 in 2011-12 and 850 in 2012-13. Based on its API base scores for 2012-13 and 2013-14, MSA-SA has achieved Statewide and Similar Schools rankings of “7” and “7”, and “8” and “10” (not in table), respectively. Overall, staff considers MSA-SA's academic performance to be supportive of a recommendation for financial soundness.

Staff also reviewed the historical academic performance data that was available for the eleven MERF schools operating during 2013-14, as shown in the tables below. Within these tables, a blank cell denotes that either the data is not available or the school was not yet opened.

| MERF API Growth Scores / Met Schoolwide API Growth Target | | | | |
|---|-----------|-----------|-----------|-----------|
| | 2009-10 | 2010-11 | 2011-12 | 2012-13 |
| MSA-1 | 800 / Yes | 807 / Yes | 805 / Yes | 797 / No |
| MSA-2 | 745 / Yes | 759 / Yes | 758 / No | 765 / No |
| MSA-3 | 777 / Yes | 754 / No | 785 / Yes | 748 / No |
| MSA-4 | 753 / Yes | 794 / Yes | 766 / No | 761 / No |
| MSA-5 | 847 / Yes | 786 / No | 843 / Yes | 759 / No |
| MSA-6 | 842 / na | 817 / Yes | 843 / Yes | 828 / Yes |
| MSA-7 | - | 855 / na | 906 / Yes | 904 / Yes |
| MSA-Bell | - | 650 / na | 713 / Yes | 763 / Yes |
| MSA-SD | 818 / Yes | 814 / Yes | 865 / Yes | 847 / Yes |
| MSA-SA | 852 / na | 777 / No | 858 / Yes | 850 / Yes |
| MSA-SC | - | 841 / na | 895 / Yes | 904 / Yes |

With respect to API growth, for the most recent reported year in 2012-13, five of the 12 schools achieved scores of greater than 800 with none of the schools scoring below 700, and 6 of the 12 schools met their Schoolwide API growth target.

| MERF API Base Rank: Statewide / Similar Schools | | | | |
|---|---------|---------|---------|---------|
| | 2009-10 | 2010-11 | 2011-12 | 2012-13 |
| MSA-1 | 7 / 10 | 8 / 10 | 8 / 10 | 8 / 10 |
| MSA-2 | 3 / 3 | 4 / 8 | 5 / 9 | 4 / 5 |
| MSA-3 | 5 / 7 | 6 / 10 | 6 / 10 | 8 / 10 |
| MSA-4 | 5 / NA | 5 / NA | 6 / 10 | 4 / 5 |
| MSA-5 | 8 / NA | 8 / 10 | 6 / 9 | 7 / 10 |
| MSA-6 | - | 8 / NA | 7 / 6 | 7 / 8 |
| MSA-7 | - | - | 8 / NA | 9 / NA |
| MSA-Bell | - | - | 1 / 1 | 2 / 2 |
| MSA-SD | 7 / 2 | 7 / 4 | 7 / 5 | 8 / 6 |
| MSA-SA | - | 8 / NA | 5 / NA | 7 / 7 |
| MSA-SC | - | - | 9 / NA | 9 / 4 |

As shown in the table above regarding MERF's statewide and similar schools rankings (base API scores), during the past four reported years, 2009-10 through 2012-13, the majority of schools had statewide and similar schools rankings of "5" or greater. During 2012-13, seven of 11 of applicable schools had statewide and similar schools rankings of "5" or greater. Only MSA-8 Bell, reflected substandard rankings in both statewide and against similar schools.

| MERF Met All AYP Criteria | | | | |
|---------------------------|---------|---------|---------|---------|
| | 2009-10 | 2010-11 | 2011-12 | 2012-13 |
| MSA-1 | No | No | No | No |
| MSA-2 | No | No | No | No |
| MSA-3 | No | No | No | No |
| MSA-4 | No | Yes | Yes | No |
| MSA-5 | No | No | No | No |
| MSA-6 | Yes | No | No | No |
| MSA-7 | - | Yes | Yes | No |
| MSA-Bell | - | No | No | No |
| MSA-SD | No | No | Yes | No |
| MSA-SA | Yes | No | Yes | No |
| MSA-SC | - | Yes | Yes | No |

Due to the increasingly difficult task of meeting all AYP criteria over successive years, among the 11 schools that were in operations for 2012-13, none of the schools met all AYP criteria and five met all AYP criteria during the previous year, 2011-12.

Overall, staff considers MERF's academic performance to be supportive of a recommendation for financial soundness.

Enrollment and Retention Rates: MSA-SA commenced operations with 63 students in grades 6 through 8 in 2009-10, and has since grown to 160 students in 2014-15. MERF is projecting MSA-SA's enrollment to grow substantially to 620 in 2016-17 (first year of project occupancy) and to 800 and 1,020 for the first two years of CSFP payments. For the past three years, 2012-13 through 2014-15, MSA-SA has shown retention rates of 82%, 92%, and 80%, respectively. For 2013-14 and 2014-15, MSA-SA, had average daily attendance (ADA) rates of approximately 95% and 98%, respectively.

MERF Enrollment and Retention Rates: The following table depict MERF’s historical, current, and projected enrollment by school (through 2018-19). Note that the enrollment projections below do not include any additional new schools.

| Magnolia Educational & Research Foundation | | | | | | | | | |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| School | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| MSA-1 | 499 | 521 | 488 | 538 | 530 | 540 | 540 | 540 | 540 |
| MSA-2 | 227 | 300 | 380 | 440 | 459 | 495 | 495 | 495 | 495 |
| MSA-3 | 257 | 293 | 379 | 426 | 452 | 475 | 500 | 500 | 500 |
| MSA-4 | 105 | 159 | 194 | 202 | 234 | 220 | 270 | 320 | 360 |
| MSA-5 | 156 | 211 | 239 | 240 | 106 | 170 | 250 | 320 | 400 |
| MSA-6 | 168 | 154 | 136 | 137 | 160 | 180 | 220 | 250 | 280 |
| MSA-7 | 96 | 121 | 233 | 301 | 295 | 316 | 330 | 350 | 360 |
| MSA-8 | 441 | 481 | 495 | 497 | 489 | 495 | 495 | 495 | 495 |
| MSA-SD | 308 | 309 | 335 | 355 | 371 | 438 | 450 | 450 | 450 |
| MSA-SC | 102 | 230 | 525 | 489 | 484 | 420 | 470 | 520 | 580 |
| PTS-OV* | 151 | 152 | 138 | - | - | - | - | - | - |
| MSA-SA | 98 | 145 | 145 | 176 | 160 | 250 | 620 | 800 | 1,020 |
| Total | 2,608 | 3,076 | 3,687 | 3,801 | 3,740 | 3,999 | 4,640 | 5,040 | 5,480 |

*ceased operations on June 30, 2013

MERF has achieved consistent enrollment growth from 188 students in one school (MSA-1) in 2002-03, to 695 students in three schools in 2007-08, and to 1,202 students in six schools in 2008-09. MERF has grown to 11 schools serving 3,740 students in 2014-15. In addition, MERF has achieved overall ADA rates of 97% for 2012-13 through 2014-15, respectively.

For the 11 schools currently in operation, MERF is projecting the following enrollment growth: 3,999 students for 2015-16 (7% growth from prior year), 4,640 for 2016-17 (16% growth from prior year), 5,040 for 2017-18 (9% growth from prior year), and 5,480 for 2018-19 (6% growth from prior year).

Aggressive Enrollment Assumptions: As previously noted, MERF anticipates substantial enrollment growth from 2014-15 to 2018-19, with enrollment projected to increase to 5,480 from 3,740. MERF’s financial soundness review in March 2012 also included aggressive enrollment assumptions, indicating enrollment reaching 7,064 students by 2014-15. Due to the challenges that faced MERF over recent years discussed in the “CMO Management”, MERF has not materially increased enrollment over the past two years. However, the current MERF management team has provided Staff with information supporting the current enrollment projections. The majority of enrollment growth is based on the anticipated growth of student population at MSA-SA following the completion of the CSFP facility. MERF staff notes that the MSA-SA CSFP facility will be located in a high demand area and plans to rapidly add grades and students through 2018-19. In the section “Projected Debt Service Coverage of CSFP Payments”, we provide an analysis that estimates the amount of student enrollment necessary for MERF to maintain the minimum debt service coverage requirement of 100% in 2017-18 and 2018-19.

With respect to the year-to-year retention rates for the most recent year, five of the 11 schools with returning students showed retention rates of 90% or more, and seven of the 11 schools showed retention rates of 85% or more, with all rates averaging 84%. MSA-5, the school with lowest retention rate in 2014-15, moved to another location and essentially had to begin enrollment of new students in middle school while forfeiting the 83 high school students it previously served. Enrollment plans

to grow at MSA-5 as the school adds grades in each subsequent year until grades 6 through 12 are served again.

Overall, staff considers MERF’s enrollment to be supportive of a recommendation for financial soundness.

Financial Analysis: Staff’s evaluation of MERF’s financial performance is based on review of the following documents: MERF’s audited financial statements for 2010-11 through 2013-14 and financial projections for 2014-15 through 2018-19.

Staff’s evaluation of MERF’s financial status is based on the following assumptions: (1) enrollment described above under “MERF Enrollment and Retention Rates”; (2) projected ADA rates of 97.0% for 2015-16 through 2018-19; (3) 2014-15 LCFF Entitlement funding rates of \$7,369 for grades K-12; (4) average LCFF per ADA rates of \$8,065, \$8,551, \$8,926, and \$9,074 for 2015-16 through 2018-19, incorporating COLA’s of 1.58%, 2.10%, 2.50%, and 2.70% in these years, respectively. The projections assume GAP funding of 32%, 11%, 13% and 13% in the projected years. (5) Expense categories including salaries and benefits show annual increases between 2-3%.

Highlighted in this section are financial data and credit indicators used to evaluate MERF’s ability to meet its CSFP obligations for its projects funded by Propositions 1D. Staff’s financial analysis is based on information for MERF as an organization and not for each applicant school on a stand-alone basis. Please note that the revenue, expenditure and changes to net assets recorded in financial audits and provided in MERF’s financial projections have been modified by staff, where necessary, to include capital outlays, operating leases and repayment of debt and other significant obligations, and to exclude non-cash items such as depreciation.

| Magnolia Education & Research Foundation | Actual FY 2012/13 | Actual FY 2013/14 | Budget FY 2014/15 | Projected FY 2015/16 | Projected FY 2016/17 | Projected FY 2017/18 | Projected FY 2018/19 |
|---|----------------------|----------------------|----------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| ENROLLMENT PROJECTIONS | | | | | | | |
| Enrollment | 3,687 | 3,801 | 3,740 | 3,999 | 4,640 | 5,040 | 5,480 |
| Average Daily Attendance | 3,542 | 3,654 | 3,655 | 3,879 | 4,501 | 4,889 | 5,316 |
| Average Daily Attendance (%) | 96% | 96% | 98% | 97% | 97% | 97% | 97% |
| FINANCIAL PROJECTIONS | | | | | | | |
| Total Revenues Available for CSFP Payment | \$ 30,647,516 | \$ 32,298,679 | \$ 33,590,537 | \$ 37,781,249 | \$ 44,320,773 | \$ 48,070,841 | \$ 52,182,894 |
| Total Expenses Paid Before CSFP Payment | 26,874,132 | 27,026,957 | 31,550,541 | 33,624,344 | 39,552,384 | 42,982,886 | 46,743,730 |
| Accounting Adjustments | 260,530 | 327,475 | 281,000 | 410,946 | 410,947 | 410,946 | 410,949 |
| Net Revenues Available for CSFP Payment | \$ 4,033,914 | \$ 5,599,197 | \$ 2,320,996 | \$ 4,567,851 | \$ 5,179,336 | \$ 5,498,901 | \$ 5,850,113 |
| CSFP Payment | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 521,674 | \$ 521,674 |
| Net Revenues After CSFP Payment | \$ 4,033,914 | \$ 5,599,197 | \$ 2,320,996 | \$ 4,567,851 | \$ 5,179,336 | \$ 4,977,227 | \$ 5,328,439 |
| FINANCIAL INDICATORS | | | | | | | |
| Net Revenues Available for CSFP Payment | \$ 4,033,914 | \$ 5,599,197 | \$ 2,320,996 | \$ 4,567,851 | \$ 5,179,336 | \$ 5,498,901 | \$ 5,850,113 |
| Debt Service Coverage by Net Revenues | N/A | N/A | N/A | N/A | N/A | 1054.1% | 1121.4% |
| Contributions | \$ 1,024,663 | \$ 130,089 | \$ 699,478 | \$ 829,000 | \$ 941,920 | \$ 1,013,040 | \$ 1,134,360 |
| Debt Service Coverage by Net Revenues (w/out Contributions) | N/A | N/A | N/A | N/A | N/A | 859.9% | 904.0% |
| CSFP Lease Payment / Revenues | N/A | N/A | N/A | N/A | N/A | 1.1% | 1.0% |
| Contributions / Revenues | 3.3% | 0.4% | 2.1% | 2.2% | 2.1% | 2.1% | 2.2% |
| Net Revenues After CSFP Payment / Revenues | 13.2% | 17.3% | 6.9% | 12.1% | 11.7% | 10.4% | 10.2% |
| Revenues / ADA | \$ 8,652 | \$ 8,839 | \$ 9,191 | \$ 9,740 | \$ 9,847 | \$ 9,833 | \$ 9,817 |
| Expenses / ADA | \$ 7,587 | \$ 7,396 | \$ 8,633 | \$ 8,668 | \$ 8,788 | \$ 8,899 | \$ 8,892 |
| Surplus (Deficit) / ADA | \$ 1,065 | \$ 1,443 | \$ 558 | \$ 1,072 | \$ 1,059 | \$ 934 | \$ 925 |
| Net Working Capital | \$ 3,355,194 | \$ 7,986,255 | | | | | |
| Net Working Capital / Expenses | 12.5% | 29.5% | | | | | |

Contributions: MERF’s contributions over the last three years were as follows: \$406,491 for 2011-12, \$1.02 million for 2012-13, and \$130,089. MERF anticipates notably higher contributions in

budgeted and projected years, ranging between \$800,000 and \$1.1 million in contributions annually. Staff notes that projected contribution levels are optimistic given the historical trend.

Long-Term Liabilities: At June 30, 2014, MERF had outstanding long-term debt of \$2.45 million. These debt obligations took the forms of six California Department of Education loans totaling approximately \$255,000, with interest rates ranging from 0.24% to 0.54%; and \$2.2 million in CSFP obligations.

School Facilities –The facility costs consist of leases (Prop 39 and Regular), and expected payments to CSFA for the funding agreements pursuant to Proposition 1D. MERF’s CSFP payments will account for the facility costs of two schools: MSA-SA - \$444,224, and MSA-SD - \$77,450.

MERF leases land and buildings for an administrative office in Westminster and leases land and buildings in Los Angeles County, Orange County, San Diego County, and Santa Clara County under various operating leases. The aggregate lease payments required under the terms of their operating leases were \$2.10 million in 2013-14 and is estimated to be \$1.36 million in 2014-15.

The facility costs (Consists of Rental, Lease, Repair, and Non-Capital Improvement Costs) for all MERF schools incorporated into the financial projections are as follows: \$2.40 million (2014-15), \$2.60 million (2015-16), \$2.65 million (2016-17), \$2.99 million (2017-18), and \$3.04 million (2018-19). These estimated expenses are equivalent to an average of 6% of annual total revenues including contributions. These levels are below the 10-15% affordability range and these commitments are not expected to impact the organization’s flexibility to respond to any unforeseen costs.

| Magnolia Educational & Research Foundation - Projected Facilities Cost | | | | | |
|---|--------------------|--------------------|--------------------|--------------------|--------------------|
| School | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
| MERF | \$168,000 | \$171,360 | \$174,787 | \$178,283 | \$181,849 |
| MSA-1 | \$504,000 | \$600,000 | \$612,000 | \$624,240 | \$636,725 |
| MSA-2 | \$99,072 | \$114,000 | \$116,280 | \$118,606 | \$120,978 |
| MSA-3 | \$220,000 | \$240,000 | \$244,800 | \$249,696 | \$254,690 |
| MSA-4 | \$140,000 | \$141,600 | \$144,432 | \$147,321 | \$150,267 |
| MSA-5 | \$99,600 | \$120,000 | \$122,400 | \$124,848 | \$127,345 |
| MSA-6 | \$96,000 | \$110,400 | \$112,608 | \$114,860 | \$117,157 |
| MSA-7 | \$229,154 | \$236,029 | \$240,750 | \$245,565 | \$250,476 |
| MSA-Bell | \$35,775 | \$41,585 | \$43,166 | \$44,029 | \$44,910 |
| MSA-SD | \$69,581 | \$89,684 | \$89,684 | \$167,134 | \$167,134 |
| MSA-SC | \$500,028 | \$510,028 | \$520,229 | \$530,634 | \$541,246 |
| MSA-SA | \$228,000 | \$228,000 | \$228,000 | \$444,224 | \$444,224 |
| Total | \$2,389,210 | \$2,602,686 | \$2,649,136 | \$2,989,440 | \$3,037,001 |

Financial Performance: Based on the audited financial statements for 2011-12, MERF experienced a net loss of \$1.07 million. At the conclusion of 2011-12, MERF was down to \$1.02 million in net fund balance and facing financial distress. Operating at a loss in 2011-12 only compounded the liquidity concerns that necessitated internal and external cash flow borrowings. However in 2012-13, operations improved at MERF and they were able to generate net revenue of \$4.03 million. This was

the result of \$30.65 million in revenues (including \$1.02 million in contributions) and \$26.61 million in adjusted expenses. In 2013-14, MERF generated an even larger surplus of \$5.60 million, including contributions of \$130,089. MERF attributes the increases in net revenue to reallocation of resources away from PTS-OV which closed at the end of 2012-13. Projected estimates for 2014-15 show revenues and adjusted expenses of \$33.59 million (including \$699,478 of contributions) and \$31.27 million, resulting in projected net revenue of \$2.32 million. Although MERF total enrollment slightly decreased from 2013-14 to 2014-15 (largely due to the relocation of MSA-5), MERF still anticipates an operating surplus.

MERF anticipates modest enrollment growth in 2015-16 but foresees a rapid increase in enrolled students once the CSFP facility is online in 2016-17. MERF's aggressive enrollment assumptions are discussed in further detail under the "MERF Enrollment and Retention Rates" section. The projected enrollment growth has a corresponding effect on projected revenues and expenditures in future years. With enrollment expecting to grow by 7% to 3,999 students in 2015-16, MERF projects increasing total revenues to \$37.78 million and adjusted expenses to \$33.21 million, for projected net revenue of \$4.57 million. MERF projects another 16% increase to 4,640 students in 2016-17. MERF expects net revenue of \$5.18 million on \$44.32 million in revenues and \$39.14 million in adjusted expenses. For 2017-18, MERF's projected enrollment growth is expected to continue by 9% to 5,040 students, resulting in net revenue of \$5.50 million after accounting adjustments. With 5,480 students expected in 2018-19, total revenues of \$52.18 million would exceed total adjusted expenses of \$46.33 million by \$5.85 million, prior to the projected CSFP lease payments.

Projected Debt Service Coverage of CSFP Payments: Assuming a 3.0% interest rate and 30-year repayment period, as well as estimated combined project cost of \$20,450,078, MERF's combined annual CSFP payment (two projects) would be \$521,674 beginning in 2017-18. MERF's projected net revenues of \$5.50 million for 2017-18 would provide debt service coverage of 1,054%, while the projected net revenues of \$5.85 million would result in debt service coverage of 1,121% for 2018-19. However, MERF's ability to meet the minimum debt service coverage is highly dependent on MERF realizing projected enrollment at its existing schools (5,480 students by 2018-19; 47% growth from 3,740 students in 2014-15).

Staff estimates that MERF would need to enroll at least 4,700 students by 2017-18 to meet the debt service coverage requirement. MERF could potentially maintain at least 100% debt service coverage on CSFP obligations with substantially less enrollment because of the ability to reduce certain expense categories (i.e. certified and classified salaries) depending on the actual enrollment in a given year. Given MERF's historical enrollment growth, Staff anticipates MERF reaching the necessary enrollment levels. The estimated enrollment needed assumes that MERF maintains a student to teacher ratio of at least 19 to 1.

Liquidity: At June 30, 2014, MERF reported holding \$5.82 million in cash and cash equivalents. Liquidity measured in terms of net working capital (NWC) is calculated by subtracting current liabilities from current assets. MERF's NWC for 2012-13 and 2013-14 was \$3.36 million and \$7.99 million, respectively, or 12.5%, and 29.5% of total expenses for these years. Staff considers NWC equivalent of at least 5.0% of total expenses to be sufficient. The NWC in 2013-14 is sufficiently higher than the 5% staff recommendation. Liquidity had been a concern for MERF schools going back to 2011-12, as MERF schools utilized external and internal cash flow borrowings to meet cash flow needs.

Strengths, Weaknesses and Mitigants

- + MERF's projected debt service coverage ratios of 1,054% in 2017-18 and 1,121% in 2018-19 exceed the minimum requirement of 100.0% by a wide margin. However, Staff estimates that MERF would need to enroll at least 4,700 students by 2017-18 to meet the debt service coverage requirement. Given MERF's historical enrollment growth, Staff anticipates MERF reaching enrollment in excess of 4,700 by 2017-18.
- + MERF has achieved enrollment growth from 2,608 students in 2010-11 to 3,740 students at 11 schools in 2014-15. In addition, MERF achieved an aggregate ADA rate of 97% between 2012-13 and 2014-15.
- MERF's ability to produce its projected debt service coverage ratios is heavily reliant on the aggressive enrollment growth projected for its existing schools.
- +/- MERF schools have continually demonstrated the ability to meet API growth targets. However, all AYP criteria was not met for the any of the MERF schools in 2012-13.

Staff Recommendations: Staff recommends that the California School Finance Authority (CSFA) Board determines that the Magnolia Educational and Research Foundation (MERF), applying on behalf of Magnolia Science Academy – Santa Ana (MSA-SA), is financially sound for purposes of the CSFP Final Apportionment. This determination as it relates to Final Apportionment is in place for six months and assumes no financial, operational, or legal material findings within this time period. This recommendation is contingent upon MERF electing to have its CSFP payments intercepted at the state level, pursuant to Sections 17199.4 and 17078.57(a)(1)(A) of the Education Code. Staff recommends that the CSFA Board direct staff to notify the Office of Public School Construction and the State Allocation Board regarding this determination.