

**CHARTER SCHOOL FACILITIES PROGRAM
2011 LOTTERY FUNDING ROUND
PROP 1D 2009 FUNDING ROUND
STAFF SUMMARY REPORT – JUNE 2011**

Applicant/Obligor:	Magnolia Educational and Research Foundation
Project School:	Pacific Technology School – Santa Ana
CDS (County – District – School) Code:	09 76596 0119537
[Proposed] Project Location:	1548 W First Street, 1434 W First Street and 1525 W Walnut Street, Santa Ana, CA
Project Type:	New Construction
County:	Orange
District in which Project is Located:	Santa 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:	\$444,224
First Year of Occupancy of New Project:	2012-13

Applicant/Obligor:	Magnolia Educational and Research Foundation
Project School:	Magnolia Science Academy – San Diego
CDS (County – District – School) Code:	37 68338 0109157
[Proposed] Project Location:	6365 Lake Atlin Avenue, San Diego, CA
Project Type:	New Construction
County:	San Diego
District in which Project is Located:	San Diego Unified School District
Charter Authorizer:	San Diego Unified School District
Total OPSC Project Cost:	\$3,036,123
State Apportionment (50% Project Cost):	\$1,158,062
Lump Sum Contribution:	\$0
Total CSFP Financed Amount:	\$1,158,062
Length of CSFP Funding Agreement:	30 years
Assumed Interest Rate:	3.00%
Estimated Annual CSFP Payment:	\$77,450
First Year of Occupancy of New Project:	2012-13

Staff Recommendation: Staff recommends that the California School Finance Authority (CSFA) Board determine that Magnolia Educational and Research Foundation (MERF), applying on behalf of Pacific Technology School – Santa Ana (PTS-SA), is financially sound for purposes of the Charter School Facilities Program (CSFP or the Program) Advance Apportionment, but not for purposes of Final Apportionment. This determination as it relates to an Advance Apportionment is in place for six months and assumes no financial, operational, or legal material findings within this time period. This determination of financial soundness is contingent upon MERF's execution of an Implementation Agreement with CSFA, the State Controller's Office and CDE, at the appropriate time, whereby CSFA will intercept MERF's state-aid portion of its General Purpose Block Grant at regular intervals to satisfy the payment requirements of its CSFP obligations. 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.

Staff recommends that the California School Finance Authority (CSFA) Board determine that Magnolia Educational and Research Foundation (MERF), applying on behalf of Magnolia Science Academy – San Diego (MSA-SD), is financially sound for purposes of the CSFP Preliminary and Advance Apportionments, but not for purposes of Final Apportionment. This determination as it relates to an Advance Apportionment is in place for six months and assumes no financial, operational, or legal material findings within this time period. This determination of financial soundness is contingent upon MERF's execution of an Implementation Agreement with CSFA, the State Controller's Office and CDE, at the appropriate time, whereby CSFA will intercept MERF's state-aid portion of its General Purpose Block Grant at regular intervals to satisfy the payment requirements of its CSFP obligations. 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 addition to its request for an advance for \$4,081,395 for Site Acquisition and Design on behalf of PTS-SA under the Program's 2011 Lottery Funding Round, MERF was recently notified by OPSC, for an approved application on behalf of Magnolia Science Academy-San Diego (MSA-SD) in the amount of \$3,036,123. MSA-SD applied for Preliminary Apportionment in 2009, but as a result of the Office of Public School Construction's assignment of preference points, MSA-SD did not receive an award. However, because MSA-SD ranked sufficiently high during that Funding Round, and certain awardees withdrew their reservation of funds for Preliminary Apportionment, MSA-SD became eligible for a Proposition 1D Preliminary Apportionment at this time. As MERF is the applicant and financial obligor for both of these schools, 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 were evaluated when conducting our financial soundness review of PTS-SA and MSA-SD. Detailed information is contained in the body of the report.

Criteria	Comments
Eligibility Criteria	PTS-SA and MSA-SD has met all Program eligibility criteria: 1) charters are in place; 2) while PTS-SA is a newly operating charter school, MERF has at least two years of instructional operations through its oversight of MSA-1, MSA-2, and MSA-SD; and 3) PTS-SA and MSA-SD are in compliance with the terms of its charters and in good standing with its chartering entities.
Demographic Information	<ol style="list-style-type: none"> 1. PTS-SA currently serves 98 students in grades 6 through 9, and projects enrollment to increase to 450 students in 2012-13 (year of project occupancy) and to 702 students in grades 6-12 in 2014-15. 2. MSA-SD currently serves 308 students in grades 6 through 8, and projects enrollment to increase to 350 students in 2012-13 (year of project occupancy) and remain consistent at 350 students through 2014-15. 3. MERF achieved successful enrollment growth from 188 students in one school (MSA-1) in 2002-03 to 709 students in three schools in 2007-08 to its current 2,608 students in twelve schools. MERF achieved an aggregate ADA rate of 96% in 2009-10 and 96% in 2010-11 (P2 Reports).
Debt Service Coverage	MERF's projected debt service coverage ratios of 1,276.2% in 2013-14 and 1,686.4% in 2014-15 (both CSFP payments) exceed the minimum requirement of 100.0%. However, MERF's ability to meet the minimum debt service coverage is highly dependent on MERF realizing projected enrollment at existing schools and the opening of new schools (6,838 students by 2013-14; 162% growth from 2,608 students in 2010-11). MERF's enrollment must be at least 5,595 students in 2013-14 to generate projected debt service coverage of at least 100.0%, which represents an 18.2% margin of error.
Other Financial Factors	<ol style="list-style-type: none"> 1. MERF has small reliance on contributions from private sources. Contributions are projected to constitute only 1.1% of revenues in 2013-14 and 2014-15. 2. The CSFP payment would represent less than 1% of projected revenues during the first two years of CSFP payment, which is well below the preferred maximum range of 10-15%. 3. Net working capital for 2009-10 of \$2.1 million represented 15.5% of total expenses, which exceeds the preferred minimum of 5.0%.
Student Performance	PTS-SA met all AYP criteria in 2009-10, and scored a base API of 825. MSA-SD has not met AYP for the last three years of testing. MSA-SD has achieved API growth scores of 803, 804, and 818, for 2007-08, 2008-09, and 2009-10, respectively.

Program Eligibility: On February 22, 2011, staff received verification from the State Board of Education (SBE), PTS-SA's charter authorizer, confirming that PTS-SA is: 1) in compliance with the terms of its charter agreement, and 2) is in good standing with its chartering authority. PTS-SA's initial charter was approved on April 1, 2009, and is due to expire on June 30, 2014. PTS-SA commenced instructional operations in September 2009.

On March 16, 2011, staff received verification from the San Diego Unified School District (SDUSD), MSA-SD's charter authorizer, confirming that MSA-SD is: 1) in compliance with the terms of its charter agreement, and 2) is in good standing with its chartering authority. MSA-SD's initial charter was approved on July 31, 2005, was renewed in 2010, and is set to expire June 30, 2015. MSA-SD commenced instructional operations in 2005-06.

Legal Status Questionnaire: Staff reviewed the response to the questions contained in the Legal Status Questionnaire (LSQ) for PTS-SA and MSA-SD. MERF indicated that it does not have any civil or criminal matters to disclose for which MERF or any of its affiliates is a party (no disclosures provided).

Project Description: PTS-SA is proposing new construction of a facility on the parcels of 1548 W First Street, 1434 W First Street and 1525 W Walnut Street, Santa Ana (*As of the Board Meeting, negotiations were still underway*), involving construction of a brand new school structure. The new facility will consist of one building housing 29 classrooms, and is anticipated for completion for 2012-2013 school year, per the schedule of MERF. The school is anticipated to have capacity for 675-700 students in grades 6-12. MERF has already submitted the updated project overview to OPSC. PTS-SA was given a preliminary apportionment of \$17,413,956 for this project, of which they are currently requesting \$4,081,395 for site acquisition.

MSA-SD is requesting \$3,036,123, and is proposing to expand the current campus by building a permanent structure on the adjacent district property located at 6365 Lake Atlin Avenue, San Diego. This property is currently leased out to MSA-SD by the San Diego Unified School District. The scope of the project consists of building a 20,000 gross square foot school complex, which will consist of twelve state of the art classrooms, two computer labs, two science labs, a multi-purpose auditorium, and faculty and administrative offices when completed. The school will be serving approximately 350-400 students, enrolled in grades 6 through 8. The project for MSA-SD has been significantly reduced, compared to their original request, due to the availability of funding that OPSC currently has due to rescissions of other schools in the Program.

Organization Information: PTS-SA commenced instructional operations in the 2009-10 academic year with 63 students in grades 6 and 7, currently has an enrollment of 98 students in grades 6-9, and anticipates expansion to grades 6-12 (chartered for grades 6-12).

MSA-SD commenced instructional operations in 2005-06 with 81 students in grade 6 and currently serves 308 students in grades 6-8 (chartered for grades 6-8).

PTS-SA and MSA-SD operate as independent charter schools 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 PTS-

SA and MSA-SD'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.

Educational 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. Since 2002, MERF has established twelve charter schools and plans to operate a total of three more charter schools within the next five years (refer to EMO management staff below).

Altogether, MERF oversees twelve charter schools of which six have begun instructional operations within the past two years. The two schools that have been in operations for three or more years, in addition to MSA-1, are MSA-2 and MSA-SD. Eight of the schools, including MSA-1, MSA-2, MSA-3, MSA-4, MSA-5, MSA-6, MSA-7, and MSA-8 operate in Los Angeles County with LAUSD as the charter authorizer. Among the four schools that operate outside of Los Angeles County, MSA-SD (San Diego County) has San Diego Unified School District as its authorizer, MSA-Santa Clara (Santa Clara County) has the Santa Clara County Office of Education as its authorizer, and both PTS-SA (Orange County) and PTS-Orangevale (Sacramento County) have the State Board of Education as their charter authorizer.

It is noteworthy that, in 2007-08, MERF became the EMO responsible for oversight and development, and prior to this time, the two schools in operation, MSA-1 and MSA-SD, operated independent of an EMO, with MERF only providing a consultative role. Additionally, based on the application materials, the California State Board of Education has approved MERF's petition to start 10 more state-wide approved MERF schools over the next six years.

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.

Mr. Ismail Hakki Karaman started as Principal of PTS-SA in January 2011. Prior to this position, he served as MBA coordinator for Doga Private Schools (2009-2010), Director of Education for Magnolia Educational and Research Foundation (2008-2009), and Director (2003-2008) of the Syracuse Academy of Science Charter School. Mr. Hakki Karaman

holds a Master in Education from the University of Nairobi in Nairobi, Kenya, and a B.A. in Economics from Bogazici University in Istanbul, Turkey.

Mr. David Yilmaz has been Principal of PTS-SA since January 2011. Prior this position, Mr. Yilmaz served as Principal of Magnolia Science Academy – San Diego (2008-2010), Dean of Academics (2006-08) and Math/Science/Computer Teacher (2005-06) at MSA-SD and Math/Science/Computer Teacher at MSA-1 (2002-05). Mr. Yilmaz holds an M.S. in Electrical and Computer Engineering from University of California, Irvine, and a Clear Single Subject Credential.

EMO Management: Dr. Suleyman Bahceci started as the CEO of MERF in 2009. Prior to this position, Dr. Bahceci served as a scientist at Exelixis, Inc. (2000-2008). Dr. Bahceci holds a Ph.D. in chemistry and biochemistry from the University of Texas.

Mr. Mekan Muhammedov has served as the CFO of MERF since 2010. Prior to this position, Mr. Muhammedov served as Business Manager for Magnolia Educational and Research Foundation (2006-2010). Mr. Muhammedov holds a B.A. in Political Science from California State University, Northridge.

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

Name	Occupation	Term
Metin Oguzmert, Board Chairman	Senior Engineer	2007-2012
Saken Sherkhanov, Board Vice Chair	Biologist	2008-2013
Mustafa Kaynak, Member	Electronics Engineer	2009-2014
Ting Sun, Member	Education	2010-2015
Bayram Yenikaya, Member	Consultant	2009-2014
Gilbert Hentschke, Member	Professor	2010-2015
Pauline Galeano, Member	Accountant	2009-2014

Management Experience for Schools Open Less than Two Years: Not applicable. MERF, as EMO to PTS-SA, has over two years of charter school management experience, and MERF has been involved in the oversight of instructional operations of MSA-SD since 2005.

Student Performance: Because of its implications for student enrollment stability and growth, staff views student performance as a leading indicator of a charter school's financial position. Schools with improving student performance trends are viewed favorable, especially if these trends exceed threshold goals set by the school or the California Department of Education (CDE). In order to measure student performance, staff utilizes Academic Performance Index (API) and Adequate Yearly Progress (AYP) trend data generated by CDE. The API is also used as an indicator for measuring AYP per the No Child Left Behind Act of 2001. Any school not meeting AYP targets would face additional mandates and corrective actions if the school is a recipient of federal Title 1 funds.

Given that MERF oversees PTS-SA and MSA-SD, staff reviewed the academic performance of all MERF schools for which academic performance has been reported, as shown in the tables below. Six of MERF's twelve schools that have been in operations for

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two or more years have available API, AYP, and State/Similar Schools ranking data. Three of the remaining six schools that have been in operations for less than two years have available Base API scores and AYP reporting data, while the remaining three schools, MSA-7, MSA-8, and MSA-Santa Clara, have no available data to date. Within these tables, a blank cell denotes that either the data is not available or the school was not yet opened. Partially omitted information within a specific cell indicates that the data is not available.

Magnolia Education and Science Foundation API Growth Scores/ Met API Growth Target						
School	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
MSA-1	749/Yes	765/Yes	767/No	781/Yes	788/Yes	800/Yes
MSA-2				703/NA	697/No	745/Yes
MSA-3					742/NA	777/Yes
MSA-4					748/NA	753/Yes
MSA-5					814/NA	847/Yes
MSA-6						842/NA
MSA-SD		739/NA	810/Yes	803/Yes	797/No	818/Yes
PTS-Orange						825/NA
PTS-SA						852/NA
MSA-SC (Opened 10-11 School Year)						
MSA-7 (Opened 10-11 School Year)						
MSA-8 (Opened 10-11 School Year)						

Magnolia Education and Science Foundation API Base Rank: Statewide/Similar Schools						
School	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
MSA-1		7/10	7/10	7/10	7/10	7/10
MSA-2					4*/N/A	3/3
MSA-3						5/7
MSA-4						5*/N/A
MSA-5						8*/N/A
MSA-6						
MSA-SD			5*/N/A	8/10	8/3	7/2
PTS-Orange						
PTS-SA						
MSA-SC (Opened 10-11 School Year)						
MSA-7 (Opened 10-11 School Year)						
MSA-8 (Opened 10-11 School Year)						

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Magnolia Education and Science Foundation Met All AYP Criteria						
School	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
MSA-1	Yes	Yes	Yes	Yes	Yes	No
MSA-2				Yes	Yes	No
MSA-3					No	No
MSA-4					Yes	No
MSA-5					Yes	No
MSA-6						Yes
MSA-SD		Yes	Yes	No	No	No
PTS-Orange						Yes
PTS-SA						Yes
MSA-SC (Opened 10-11 School Year)						
MSA-7 (Opened 10-11 School Year)						
MSA-8 (Opened 10-11 School Year)						

Among the six schools that have been in operations for at least two years, none of the schools met all AYP criteria for the most recent reported year, 2009-10, due to a failure to meet the percent proficient requirement in one or more subcategories.

Staff notes that the percent-proficient threshold requirement for AYP, both for English-language arts and mathematics, in accordance with the Elementary and Secondary Education Act (ESEA), reflects increases each year and will continue to reflect increases until 2014. Therefore, with each successive year, charter schools are increasingly challenged in “making AYP” (meeting all AYP criteria). This requirement applies to both school wide performance and performance of each numerically significant subgroup within any school. As an example, since 2002, the percent-proficient requirements for English-language arts (elementary schools, middle schools, and elementary school districts) are as follows: 13.6% for each of 2001-02, 2002-03, and 2003-04; 24.4% for each of 2004-05, 2005-06, and 2006-07; 35.2% for 2007-08; 46.0% for 2008-09; and 56.8% for 2009-10. This specific requirement will increase up until 2014 with the following percent-proficient thresholds: 67.6% for 2010-11; 78.4% for 2011-12; 89.2% for 2012-13; and 100.0% for 2013-14. The English-language arts percent-proficient requirement for high schools shows a similar trend, as do the percent-proficient requirements for mathematics for both elementary schools and high schools. Given that each numerically significant subgroup within a school must meet the percent-proficient requirement in English-language arts and mathematics in order for the school to make AYP, and given the high prevalence of English-language learners in California, charter schools are faced with increasing difficulty in making AYP¹.

All of these schools however met their API growth targets with three of the schools having achieved API growth scores of greater than 800. All three schools that have been in operations for less than two years, PTS-SA, PTS-Orange, and MSA-6 have met all AYP criteria for 2009-10, and had base API scores of 852, 825 and 842, respectively. With respect to rankings, MSA-1 has shown consistently high rankings for the past five years of 7 statewide and 10 against similar schools (10 = best). MSA-SD achieved a statewide ranking of 7 and a similar schools ranking of 2 in the 2009-10 school year.

¹ Information regarding AYP requirements are derived from the California Department of Education’s “2010 Adequate Yearly Progress Report Information Guide.”

Enrollment and Retention Rates: PTS-SA currently has 98 students in grades 6 through 9, and through the addition of grades up to grade 12 and the expansion of class sizes, MERF is projecting PTS-SA’s enrollment to grow to 450 students in 2012-13 (first year of project occupancy) and to 525 students in grades 6-12 in 2013-14 (first year of CSFP payments).

MSA-SD has shown consistent enrollment growth from 81 students in grade 6 in 2005-06 to 274 students in grades 6-8 in 2008-09 to its current 308 students in grades 6-8. MERF is projecting MSA-SD’s enrollment to grow to 350 students in grades 6-8 in 2011-12 and to remain stable at that level through 2014-15 (all projected years).

MERF Enrollment and Retention Rates: The tables below depict MERF’s historical, current, and projected enrollment by school (through 2014-15. It should be noted that the enrollment projections below do incorporate MERF’s plans to add 3 more state-wide approved schools over the next five years as a result of the State Board of Education’s approval of MERF’s petition to start such schools (10 schools in total).

Magnolia Education and Research Foundation Historical and Projected Enrollment													
School	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
MSA-1	188	276	396	391	430	402	419	478	499	525	525	525	525
MSA-2						58	157	227	227	350	475	550	550
MSA-3							228	151	257	325	425	525	600
MSA-4							61	98	105	275	425	525	600
MSA-5							63	115	156	237	350	525	600
MSA-6								74	168	225	375	500	625
MSA-7									96	232	412	568	596
MSA-8									441	495	495	495	495
MSA-SD				81	135	249	274	328	308	350	350	350	350
MSA-SC									102	225	325	425	525
PTS-Orange								67	151	277	450	600	675
PTS-SA								63	98	206	450	525	702
Projected - 1											275	325	490
Projected - 2												275	390
Projected - 3												125	270
Totals	188	276	396	472	565	709	1202	1601	2608	3722	5332	6838	7993

MERF has achieved enrollment growth from 276 students in one school (MSA-1) in 2003-04 to 709 students in three schools in 2007-08 to its current 2,608 students in twelve schools. In addition, MERF has achieved an aggregate ADA rate of 96% for school years 2007-08, 2008-09, and 2009-10, and 96% for the 2010-11 school year (P2 Reports). For the twelve schools currently in operation and the projected opening of three more schools, MERF is projecting the following enrollment growth: 2,608 students for the current 2010-11 academic year; 3,722 students for 2011-12 (43% growth from prior year); 5,332 students for 2012-13 (43% growth from prior year), 6,838 for 2013-14 (28% growth from prior year) and 7,993 for 2014-15 (17% growth from prior year and 206% growth from current year).

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Year to Year Retention Rates				
School	2007-08	2008-09	2009-10	2010-11
MSA-1	73%	83%	90%	99%
MSA-2		87%	74%	90%
MSA-3			68%	81%
MSA-4			85%	74%
MSA-5			63%	75%
MSA-6				97%
MSA-SD	84%	76%	91%	93%
PTS-SA				95%
PTS-Orange				100%

With respect to the year-to-year retention rates, for the most recent year, six of the nine schools with returning students showed retention rates of 90% or more, with all prior rates having been less than 91%. Staff will continue to monitor the retention rates at MERF schools.

Financial Analysis: Highlighted in this section is financial data and credit indicators used to evaluate MERF’s ability to meet both projects’ CSFP obligations. The table below summarizes key aspects of the obligor’s past and projected financial performance.

Staff’s analysis of financial performance includes adjustments for capital outlay and loan repayment; therefore, our results may differ from audited figures presented by MERF’s representatives.

Magnolia Educational and Research Foundation	Actual FY 2007-08	Actual FY 2008-09	Actual FY 2009-10	Budgeted FY 2010-11	Projected FY 2011-12	Projected FY 2012-13	Projected FY 2013-14	Projected FY 2014-15
ENROLLMENT PROJECTIONS								
Enrollment	709	1,202	1,601	2,608	3,722	5,332	6,838	7,993
Average Daily Attendance	685	1,155	1,593	2,530	3,610	5,172	6,633	7,753
Average Daily Attendance (%)	97%	96%	99%	97%	97%	97%	97%	97%
FINANCIAL PROJECTIONS								
Total Revenues Available for CSFP Lease Payment	\$ 6,222,419	\$ 11,520,224	\$ 14,346,862	\$ 20,261,437	\$ 26,902,474	\$ 41,863,352	\$ 55,513,450	\$ 69,048,993
Total Expenses Paid Before CSFP Lease Payment	6,139,043	10,621,556	13,315,319	17,659,864	23,198,073	36,959,830	49,534,918	61,098,420
Accounting Adjustments	207,367	205,874	140,929	160,000	270,000	510,000	679,000	847,000
Net Revenues Available for CSFP Lease Payment	\$ 290,743	\$ 1,104,542	\$ 1,172,472	\$ 2,761,573	\$ 3,974,401	\$ 5,413,522	\$ 6,657,532	\$ 8,797,573
CSFP Lease Payment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 521,674	\$ 521,674
Net Revenues After CSFP Lease Payment	\$ 290,743	\$ 1,104,542	\$ 1,172,472	\$ 2,761,573	\$ 3,974,401	\$ 5,413,522	\$ 6,135,858	\$ 8,275,899
FINANCIAL INDICATORS								
Net Revenues Available for CSFP Lease Payment	\$ 290,743	\$ 1,104,542	\$ 1,172,472	\$ 2,761,573	\$ 3,974,401	\$ 5,413,522	\$ 6,657,532	\$ 8,797,573
Debt Service Coverage by Net Revenues	N/A	N/A	N/A	N/A	N/A	N/A	1276.2%	1686.4%
Contributions	\$ 93,666	\$ 111,840	\$ 57,565	\$ 387,601	\$ 426,447	\$ 534,151	\$ 630,292	\$ 727,362
Debt Service Coverage by Net Revenues (w/out Contributions)	N/A	N/A	N/A	N/A	N/A	N/A	1155.4%	1547.0%
CSFP Lease Payment / Revenues	N/A	N/A	N/A	N/A	N/A	N/A	0.9%	0.8%
Contributions / Revenues	1.5%	1.0%	0.4%	1.9%	1.6%	1.3%	1.1%	1.1%
Net Revenues After CSFP Lease Payment / Revenues	4.7%	9.6%	8.2%	13.6%	14.8%	12.9%	11.1%	12.0%
Revenues / ADA	\$ 9,085	\$ 9,975	\$ 9,007	\$ 8,009	\$ 7,452	\$ 8,094	\$ 8,369	\$ 8,906
Expenses / ADA	\$ 8,964	\$ 9,197	\$ 8,360	\$ 6,981	\$ 6,425	\$ 7,146	\$ 7,547	\$ 7,948
Surplus (Deficit) / ADA	\$ 122	\$ 778	\$ 648	\$ 1,028	\$ 1,026	\$ 948	\$ 823	\$ 958
Net Working Capital	\$ (265,795)	\$ 608,297	\$ 2,060,059	\$ -	\$ -	\$ -	\$ -	\$ -
Net Working Capital / Expenses	N/A	5.7%	15.5%	N/A	N/A	N/A	N/A	N/A

Staff’s financial analysis of MERF is based upon review of the following documents: (1) three years of audited financial statements (2007-08 through 2009-10), (2) 2010-11 second interim report; and (3) multi-year budget projections from 2011-12 through 2014-15. Additionally, MERF provided enrollment projections through 2014-15.

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Contributions: MERF’s contributions over the last three years were as follows: \$93,666 for 2007-08, \$111,840 for 2008-09, and 57,565 for 2009-10. MERF, however, anticipates substantially higher contributions in budgeted and projected years, averaging \$283,726 in contributions annually. Staff notes that projected contribution levels are optimistic given the historical trend. CDE start-up grants are included in MERF’s revenues but excluded from the contribution discussion.

Financial Performance: MERF’s financial projections are based upon the following assumptions: (1) occupancy of both CSFP projects in 2012-13; (2) increases in enrollment as described above; (3) 2010-11 funding rates for the charter school general purpose block grant of \$5,077, \$5,153, \$5,306, and \$6,158 for grades K-3, 4-6, 7-8, and 9-12, respectively; (4) projected ADA rates of 97%, which is consistent with MERF’s historical performance; (5) revenue growth (cost of living adjustments) on charter school block grant and to certified salaries of -1% for 2011-12 and 2.0% for 2012-13 through 2014-15 and (8) MERF maintaining a teacher to student ratio of 17:1. Expense categories other than salaries and benefits, such as books and supplies, services and miscellaneous expenses, are increased to reflect enrollment growth

Long-Term Liabilities: At June 30, 2010, MERF had outstanding long-term liabilities of \$1.23 million. These debt obligations took the forms of four capital leases (\$68,804); eight California Department of Education loans (\$1.06 Million - .53% – 1.57%); three drawn lines of credit (\$96,663 – Banks Reference Rate Plus 2.5%); and one Promissory Note (\$11,910 – 7%). Annual payments due under these various obligations will be paid before annual payments are made on the CSFP funding agreements for the projects funded by Propositions 1D. Of these liabilities, \$387,613 is due prior to June 30, 2011. Four of these obligations are in connection with PTS-SA and MSA-SD with the rest attributable to MSA-2, MSA-3, MSA-4, MSA-5, PTS-Orangevale, and MERF.

Magnolia Educational and Research Foundation Debt Service					
School	2010-11	2011-12	2012-13	2013-14	2014-15
MSA-2	\$ 51,097	\$ 50,486			
MSA-3	\$ 65,160	\$ 64,208	\$ 63,257		
MSA-4	\$ 20,313	\$ 20,390	\$ 20,287	\$ 20,185	\$ 20,082
MSA-5	\$ 20,313	\$ 20,390	\$ 20,287	\$ 20,185	\$ 20,082
MSA-6	\$ 20,313	\$ 20,390	\$ 20,287	\$ 20,185	\$ 20,082
PTS-SA	\$ 20,313	\$ 20,390	\$ 20,287	\$ 20,185	\$ 20,082
Total	\$ 197,509	\$ 196,254	\$ 144,405	\$ 80,740	\$ 80,328

School Facilities – MERF anticipates operating 15 charter schools with a projected enrollment of 7,993 students by 2014-15. 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: PTS-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, Santa Clara County, and Sacramento County under various operating leases. The financial audit notes

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that it is unlikely that MERF will cancel any of these operating leases before they expire. The aggregate rental payments required under the terms of their operating leases ranges from a high of \$1.38 million in 2010-11 to a low of \$61,620 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: \$1.81 million (2010-11), \$2.14 million (2011-12), \$3.52 million (2012-13), \$4.66 million (2013-14), and \$5.71 million (2014-15). These estimated expenses are equivalent to an average of 8% 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 and Research Foundation Projected Facilities Costs						
School	2010-11	2011-12	2012-13	2013-14	2014-15	Type of Lease
MSA-Foundation	\$ 62,500	\$ 62,500	\$ 62,500	\$ 62,500	\$ 62,500	Lease
MSA-1	\$ 426,500	\$ 445,500	\$ 415,000	\$ 515,000	\$ 515,000	Lease
MSA-2	\$ 150,000	\$ 150,000	\$ 150,000	\$ 150,000	\$ 150,000	Prop 39/ Multi year
MSA-3	\$ 101,200	\$ 110,000	\$ 720,000	\$ 720,000	\$ 720,000	Prop 39
MSA-4	\$ 49,500	\$ 68,000	\$ 247,500	\$ 382,500	\$ 540,000	Prop 39
MSA-5	\$ 51,200	\$ 75,500	\$ 247,500	\$ 382,500	\$ 540,000	Prop 39
MSA-6	\$ 108,000	\$ 108,000	\$ 247,500	\$ 382,500	\$ 540,000	Lease
MSA-7	\$ 132,000	\$ 65,000	\$ 247,500	\$ 382,500	\$ 540,000	Lease
MSA-8	\$ 120,000	\$ 200,000	\$ 200,000	\$ 200,000	\$ 200,000	Public School choice
MSA-SD	\$ 60,000	\$ 60,000	\$ -	\$ -	\$ -	Lease
MSA-SC	\$ 22,500	\$ 204,000	\$ 340,000	\$ 340,000	\$ 450,000	Prop 39/ Multi year
PTS-OV	\$ 264,000	\$ 264,000	\$ 264,000	\$ 350,500	\$ 350,500	Lease
PTS-SA	\$ 165,000	\$ 210,000	\$ -	\$ -	\$ -	Lease
Proj.1	-	-	\$ 247,500	\$ 292,500	\$ 350,000	Lease
Proj.2	-	-	-	\$ 244,800	\$ 350,000	Lease
Proj.3	-	-	-	\$ 112,500	\$ 243,000	Lease
TOTALS	\$ 1,712,400	\$ 2,022,500	\$ 3,389,000	\$ 4,517,800	\$ 5,551,000	

Based on the audited financial statements for 2007-08, MERF recorded net revenues of \$83,376 on revenues of \$6.1 million and expenses of \$6.1 million. Excluding contributions in 2007-08, MERF operated at a net loss of (\$10,290). In 2008-09, MERF ended with a net surplus after contributions, and would have recorded a net income of \$718,120 if contributions of \$111,840 are excluded. In 2009-10, MERF increased net assets by \$1.0 million, including contributions of \$57,565. This was the result of \$14.3 million in revenues and \$13.3 million in expenses.

On total revenues and expenses of \$20.3 million and \$17.7 million, MERF's second interim budget estimate for 2010-11 indicates increased net assets by \$2.8 million. As MERF's enrollment is expected to rapidly increase from year to year, the organization anticipates large increases to both revenue and expenses. With enrollment expecting to grow by 43% to 3,722 students next year (2011-12), MERF projects increasing total revenues to \$26.5 million, and expenses to \$23.2 million, for a net increase of \$3.3 million. In the first year of the CSFP project occupancy, 2012-13, MERF projects an enrollment of 5,332 students and a wide margin between revenues and expenses as no lease payment for their one CSFP facilities would be required. MERF expects an increase to net assets of \$4.7 million on \$41.3 million in revenues and \$37.0 million in expenses. MERF's projected enrollment

growth is expected to continue into 2013-14 with 6,838 students, resulting in an increase to net assets of \$5.3 million before payment of the expected CSFP lease obligations. With student enrollment of 7,993 students expected for 2014-15, total revenues of \$68.3 million would exceed total expenses of \$61.1 million by \$7.2 million, before CSFP lease payments are expensed.

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 \$20,450,079, MERF's combined annual CSFP payment (two projects) would be \$521,674 beginning in 2013-14. MERF's projected net revenues of \$6.7 million for 2013-14 would provide debt service coverage of 1,276.2%, while the projected net revenues of \$8.8 million would result in debt service coverage of 1,686.4% for 2014-15. However, MERF's ability to meet the minimum debt service coverage is highly dependent on MERF realizing projected enrollment at its existing schools (5,332 students by 2012-13; 104% growth from 2,608 students in 2010-11). MERF's enrollment must be at least 5,595 students in 2013-14 to generate projected debt service coverage of at least 100.0%, which represents an 18.2% margin of error.

Liquidity: At June 30, 2010, MERF reported holding \$1.4 million in cash or cash equivalents. Liquidity measured in terms of net working capital (NWC) is calculated by subtracting current liabilities from current assets. MERF's NWC for 2007-08, 2008-09, and 2009-10 was (\$265,795), \$608,297, and \$2.0 million respectively, or less than 0%, 5.7%, and 15.5% of total expenses for these years. Staff considers NWC equivalent of at least 5.0% of total expenses to be sufficient. Although NWC as a percentage of expenses was higher than 5% in 2008-09 by a small margin, the NWC in 2009-10 is sufficiently higher than the 5% staff recommends.

Strengths, Weaknesses and Mitigants

- + MERF projects debt service coverage of 1,276.2% in 2013-14, and 1,686.4% in 2014-15
- + MERF has achieved enrollment growth from 188 students at one school (MSA-1) in 2002-03 to 709 students at three schools in 2007-08 to its current 2,608 students at twelve schools. In addition, MERF achieved an aggregate ADA rate of 97% between 2007-08 and 2010-11.
- +/- MERF schools have continually demonstrated the ability to meet API growth targets. However, AYP scores have not been met for MERF schools. Staff will continue to monitor the AYP scores and all testing data for MERF schools in the future.
- MERF's ability to produce its projected debt service coverage ratios is heavily reliant on the aggressive enrollment growth projected for its existing schools.

Staff Recommendations: Staff recommends that the California School Finance Authority (CSFA) Board determine that Magnolia Educational and Research Foundation (MERF), applying on behalf of Pacific Technology School – Santa Ana (PTS-SA), is financially sound for purposes of the Charter School Facilities Program (CSFP or the Program) Advance Apportionment, but not for purposes of Final Apportionment. This determination as it relates to an Advance Apportionment is in place for six months and assumes no financial, operational, or legal material findings within this time period. This determination of financial soundness is contingent upon MERF’s execution of an Implementation Agreement with CSFA, the State Controller’s Office and CDE, at the appropriate time, whereby CSFA will intercept MERF’s state-aid portion of its General Purpose Block Grant at regular intervals to satisfy the payment requirements of its CSFP obligations. 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.

Staff recommends that the California School Finance Authority (CSFA) Board determine that Magnolia Educational and Research Foundation (MERF), applying on behalf of Magnolia Science Academy – San Diego (MSA-SD), is financially sound for purposes of the CSFP Preliminary and Advance Apportionments, but not for purposes of Final Apportionment. This determination as it relates to an Advance Apportionment is in place for six months and assumes no financial, operational, or legal material findings within this time period. This determination of financial soundness is contingent upon MERF’s execution of an Implementation Agreement with CSFA, the State Controller’s Office and CDE, at the appropriate time, whereby CSFA will intercept MERF’s state-aid portion of its General Purpose Block Grant at regular intervals to satisfy the payment requirements of its CSFP obligations. 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.