

MEMORANDUM

**Date:** July 30, 2009 Staff Summary No. 8

**To:** Members of the California School Finance Authority

**From:** Katrina M. Johantgen, Executive Director

**Subject:** Resolution No. 09-12 Approving Policy Recommendation Regarding Guidelines for a Current Financing Soundness Determination

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Consideration of guidelines for identifying the length of time a determination of financial soundness should remain valid.

**Background:** Chapter 935, Statutes of 2002, established the Charter School Facilities Program (Program) as a pilot program for the purpose of providing charter schools with funding to construct new facilities. Modeled after the State's School Facilities Program, the Program funds 50% of the project costs as a grant from the State, and the charter school is responsible for the balance of the project costs through either a lump sum matching payment, or a long-term loan from the State.

The California School Finance Authority (Authority) and the State Allocation Board (SAB), staffed by the Office of Public School Construction (OPSC), jointly administer the per-pupil facilities Program. The law delineates each agency's roles as they relate to the Program. Among other things, the Authority is responsible for: 1) making a financially sound determination for all Program applicants at the time of preliminary, advance and final apportionment; 2) conducting ongoing monitoring and due diligence of recipients' financial soundness; 3) carrying out due diligence on guarantors, if applicable; 4) developing, negotiating, and maintaining Program agreements on behalf of the State; and 5) integrating Program funding into the Authority's existing financing program.

Charter schools that receive a Preliminary Apportionment (reservation of funds) have approximately four years to begin building the approved project facilities. During this period, the school may request fund releases for advance apportionments for design costs or site acquisition, and a final fund release apportionment when construction is set to commence. Whenever a school files for an advance or final apportionment, they must receive an updated determination of financial soundness from the Authority, and submit form SAB 50-05 to OPSC requesting the fund release. A charter school that requests a fund release from OPSC needs to, among other things, certify to its current financial soundness status by the Authority. The requirement for a current finding of financial soundness is based on OPSC's regulations, Section 1859.167 (a), which states "Prior to the Board providing a Final Charter School Apportionment, the Charter School will need to have a current Financial Soundness certification from the Authority".

**Issue:** The SAB disburses funds for Program projects by taking short term loans from the State's Pooled Money Investment Account. In 2008, the global financial markets began to deteriorate, and California's economy and ability to raise capital also worsened. As a result,

in December 2008, the Pooled Money Investment Board ceased making short term loans for all State infrastructure projects, including charter school projects funded through the Program. The State issued two bond issues to replenish the PMIA, and begin funds flowing back into state infrastructure projects. However, the amount of bond proceeds is insufficient to fund all projects awaiting funds. OPSC has continued to accept applications for fund releases so that projects can queue up in date/stamp order to begin receiving funds once they become available. While the State is facing this cash flow issue to fund projects, charter schools have been requesting that the Authority provide a current determination of their financial soundness so they can indicate on Form SAB 50-05 they have met the requirements and get in line at OPSC. Given the state's fiscal crisis, there is no indication of when the State can access the capital markets to issue bonds to fund projects. This new situation is calling into question the length of time the financial soundness review performed by the Authority should be considered "current."

At its June 30, 2009 meeting, Authority members directed staff to work with our colleagues at OPSC to develop benchmarks or guidelines to define current as the term is used when addressing a school's "current" financial soundness.

Staff's financial soundness recommendation to members also includes a caveat about material changes impacting a school's financial soundness. Excerpted from a current report, ***"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."*** Authority members and staff discussed this issue of material changes, and what constitutes a material change, and under what circumstance would a charter school need to notify staff.

Set forth below are staff's recommendations related to the issue of a current financial soundness determination and the issue of material changes.

**Current Financial Soundness:** Section 1859.167 of the Office of Public School Construction (OPSC) regulations regarding the Charter Schools Facilities Program (Program) states that "prior to the Board providing a Final Charter School Apportionment, the Charter School will need to have a current Financial Soundness certification from the (California School Finance) Authority." Additionally, SAB Form 50-05 (Fund Release Authorization) includes certifications that state "the Charter School certifies it has current financial soundness status from the California School Finance Authority."

Key financial and operational data become available throughout the year, therefore staff is continually analyzing a school's viability. When a school comes in for a fund release for an advance or final apportionment to OPSC, the school is referred to the Authority for a financial soundness determination.

**Current Financial Soundness Recommendation:** Authority staff recommends that its findings related to a school's or operator's financial soundness be in place for six months from the date of Authority board approval to the time that a fund release is submitted by the charter school to OPSC. Following a determination of financial soundness, Authority staff will provide written notification to OPSC certifying the board's determination as well as

provide an expiration date of the determination. The notification also will include any additional or extenuating criteria or requirements for fund release contained in staff's finding and resolution approved by the board.

Subsequent financial soundness determinations outside of the six-month determination would require board approval; however, the analysis will in most cases be more cursory and less onerous on the school. The depth of the Authority's subsequent analysis will be based on factors that staff highlighted in its findings to members and subject to monitoring by Authority staff, and may require the analysis of updated financial information, charter renewal information, newly-released student performance data, and retention or enrollment information. The level of the Authority's analysis will be directly proportionate to the changes in the aforementioned factors. The analysis also may contain new information or changes to the charter school's operations that staff deems material.

As for those schools whose fund releases are being held up by the state's cash flow dilemma, staff is recommending a new financial soundness review be performed by the Authority if the release request date is more than six months from the Authority's initial determination. The Authority recommends that OPSC inform the Authority as soon as it becomes aware that funds may become available so that a new determination can be made in a timely manner so as not to delay the fund release. In the alternative, a school may request a new determination immediately upon the expiration of the six month period.

Each school's staff report and corresponding resolution will contain a financial soundness expiration date. The recommendation also would contain any updates that may be required prior to any fund releases.

Any caveats related to material changes will be contained in all financial soundness recommendations to the board. Given the characteristics of certain situations, staff may outline specific material changes identified as reportable during the six month period. Based on requirements outlined in the Authority's Program regulations, charter schools also have an obligation to notify the Authority of any materials changes to their operations. All such changes also will be considered in any subsequent analysis.

**Interim Recommendation:** The Authority recommends that the Board and State Allocation adopt the policy outlined in this memo regarding financial soundness reviews conducted by the Authority.