M E M O R A N D U M **Staff Summary No. 6**

Date: May 4, 2020

To: Members of the California School Finance Authority

From: Katrina M. Johantgen, Executive Director

Subject: Resolution No. 20-11 – Approval of the Revolving Loan Fund Program Recommendations and Amounts (Action Item)

<u>Overview</u>: In December 2019, the California School Finance Authority (Authority) opened the Revolving Loan Fund Program (Program) application period for the 2019-20 funding round. The Authority received 30 timely applications by the February 28, 2020 deadline, with funding requests totaling $7.35 million with approximately $15 million in available funding. Since February 2020, Authority staff have assessed eligible loan applications, following the framework established by statute and regulation, and adhered to the review process described below.

Since receiving applications in late February 2020, the COVID-19 pandemic has created widespread economic uncertainty. In an effort to alleviate cash-flow issues for schools, Authority staff is recommending that P2 schools receive loan proceeds in advance of P1 schools as P2 schools have several eligibility criteria already in place. P1 schools are not eligible for funding until early- to mid-summer as they wait for things such as charter numbers, CDS (county-district-school) codes, facilities, etc. This is a reversal of how loan awards have been made since the Authority started administering this Program. However, there is ample funding for P2 and P1 schools.

Staff reviewed two tiers of applications: (1) 16 schools opening in 2020-21, which the Authority classifies as priority one (P1) applications; and (2) 12 schools that have already opened which the Authority classifies as priority two (P2) applications. At this time, staff is recommending 12 loans for board approval for the P2 schools listed in Exhibit A of Resolution No. 20-11 at our May 4, 2020 meeting. The P1 schools, since the Program is undersubscribed, will be brought to the board in a future meeting once all approval conditions are satisfied.

<u>Staff Review Process:</u> Since the Authority began administering the Program in 2013-14, staff and our advisors have worked through regulations, policy and underwriting criteria, to mitigate Program defaults and maintain the balance in the Program fund to ensure future loan awards can be made. While understanding some defaults are unavoidable, due to the nature of the program[1], the Authority continues to develop methods and practices to mitigate losses.

Based on an analysis of defaulted loans, staff determined the primary reason for Program defaults is that realized enrollment figures were well below the borrowers' expectations at the time initial loan awards were made. With roughly 95% of a new charter schools' revenue dependent on reported Average Daily Attendance (ADA), the accuracy of projected attendance has a considerable impact on financial performance in comparison to a school's management of expenses. In the previous two funding rounds, the Authority refined its financial model by requiring more stringent confirmation regarding enrollment totals and developing a disbursement timeline in which applicants are disbursed loan proceeds only when enrollment and financial projections are met. Below is an outline of our application review, loan underwriting, and funding process.

1. **<u>Application Eligibility & Package Review</u>:** Confirmed the submittal complied with application terms such as:
    - Met application deadline;
    - Eligibility requirements set forth in regulations (Section 10170.18);
    - Submitted required documentation with signatures, where applicable;
    - Requested a loan amount equal to or less than $250,000; and
    - Requested a loan repayment period of five years or less.

2. **<u>Operational Analysis</u>**: Determined whether minimum qualifications were met such as:
    - Articles of Incorporation are in place;
    - Approved charter is in place or is in process;
    - Detailed business and marketing plan completed;
    - Board of Director listing submitted with no apparent conflicts;
    - Key staff resumes demonstrate relevant education and experience;
    - Projected enrollment and ADA are supported by student enrollment and/or waiting lists;
    - Student population was deemed representative of the demographic in the school's proposed location; and
    - A facility has been secured or is in the process of being secured.

3. **<u>Financial Analysis</u>:** Conducted fiscal evaluation based on a variety of indicators and critically analyzed financial data and ratios against benchmarks and industry practice using an internally created financial model to identify fiscal strengths and weaknesses such as:
    - Availability of other sources of funding;

[1] Section 41365(e) of the Education Code states, "Priority for loans from the Charter School Revolving Loan Fund shall be given to new charter schools for startup costs."

- Reasonableness of budget assumptions (staff applied uniform LCFF funding rates to all applicants);
- Alignment of revenue and expenditure projections with comparable data available from the California Department of Education (CDE);
- Consideration of sale of apportionments to third parties; and
- Adequacy of debt service coverage (DSC) metrics relative to threshold levels, with and without net assets.

The Authority's financial analysis rates default risk and approves schools using an internal point system. Staff utilizes three DSC metrics: (1) DSC from total state aid subject to CSFA intercept; (2) DSC from net revenues; and (3) DSC from net revenues plus beginning net assets. Threshold levels are set for each of these three metrics. If the applicant is projected to exceed these threshold levels during the years of loan repayment, then a maximum 70 points are recorded. The applicant may receive up to an additional 30 points, for a maximum score of 100 points, if the DSC threshold levels are attained under a scenario wherein projected attendance levels are reduced by 25%, which is the Authority's internal stress test. Applicants that meet or exceed 50 points qualify as passing in the context of the Program's loan underwriting standards. Staff also reduced loan amounts for applicants that do not otherwise meet the threshold underwriting DSC standards, with a minimum $100,000 loan.

The financial model also determines the risk profile of an applicant with a passing score. Applicants with scores ranging from 50.0 to 74.9 are viewed as "high risk", while applicants with scores ranging from 75.0 to 89.9 are deemed "medium risk", and applicants with scores ranging from 90.0 to 100.0 are considered "low risk". Schools determined to be medium risk and low risk have attained sufficient DSC ratios in some or all years under the stress test scenario. Additionally, any application, which includes a loan guarantee from an affiliated organization deemed credible by staff, has its risk profile improved by one level, such as from "higher risk" to "medium risk".

4. **<u>Loan Recommendations</u>:** Staff considered all operational and financial information and assumptions for each loan and performed the following:
    - Assigned risk profiles—low, medium, or high;
    - Sorted applicants by priority in accordance with California Code of Regulations §10170.17(o) through (r) and §10170.20(c) through (e); and
    - Based on the availability of funds, recommended specific loans for approval or non-approval.

5. **<u>Amount and Term</u>:** Furthermore, staff relied on Section 10170.21(b)(1) of the Program regulations to identify the recommended loan amount and repayment period of each loan. The regulations state the Authority shall consider the term of the charter as well as the loan amount in determining the repayment period.

To mitigate default risk, staff based the recommended loan amount and repayment period on the school's charter term. Staff recommended each applicant have a repayment period that does not exceed the school's charter term. Additionally, staff recommended each applicant be awarded a loan that can be repaid within the loan term based on the results of the financial analysis described above.

6. **Disbursements:** In an effort to reduce losses to the Program, staff will continue to reduce loan defaults by (1) continue the current frequency of attendance monitoring in the year of loan award, and (2) limiting loan disbursements to borrowers with attendance certified at levels consistent with previously submitted projections. For any loan amount approved by the board for lower risk applicants, the first of two potential loan disbursements would occur after loan documents are executed, up to a maximum amount of 40% of loan amount. The subsequent disbursements of the remaining 60% will occur once CDE certifies the applicant's attendance, typically in mid to late December. For any loan amount approved by the board for medium or higher risk applicants, the first of three potential loan disbursements would occur after loan documents are executed, up to a maximum amount of 40% of loan amount. The two subsequent disbursements would be up to 30% of the remaining amount. Each disbursement would occur in the months after CDE certifies attendance, usually in December and February. Borrowers reporting attendance levels insufficient to repay the loan will have future disbursements decreased and/or potentially eliminated.

For your review and consideration, staff provides summary findings for each recommended school in the attached Exhibit A – RLF Board Matrix. In order to receive funding through the Program, schools must meet the following criteria, once approved by the Authority board:

- Continue to meet all eligibility criteria;
- Have an approved charter in place;
- Have a Charter Number from CDE;
- Have been assigned a County-District-School Code from CDE; and
- Provide an executed loan agreement and related governing board resolution to the Authority.

Recommendation: Staff recommends the Board adopt Resolution No. 20-11, approving Revolving Loan Fund Program recommendations and amounts to the schools listed in the attached Exhibit A – *Charter School Revolving Loan Fund Program P2 Schools*. Once approved, staff will notify schools of the conditional loan approvals, confirm schools meet all funding criteria before releasing funds, distribute and execute loan agreements, and carry out all other necessary steps to disburse funds to schools.

Attachment A
Charter School Revolving Loan Fund Program
P2 Schools

List of charter schools that may be considered for approval, as known by the Authority at the time of posting of this Agenda:

#	Charter School Name	County	Requested Loan
1	Baypoint Preparatory Academy - San Diego	San Diego	$100,000
2	Brookfield Engineering Science Technology Academy	San Diego	$250,000
3	California Innovative Career Academy	Sacramento	$250,000
4	College Preparatory Middle	San Diego	$250,000
5	Heartwood Charter	Sonoma	$250,000
6	JCS - Cedar Cove	San Diego	$250,000
7	JCS - Manzanita	San Diego	$250,000
8	JCS - Pine Valley	San Diego	$250,000
9	Kidinnu Academy	San Diego	$250,000
10	Learning Choice Academy - Chula Vista	San Diego	$250,000
11	Shasta View Academy	Modoc	$250,000
12	The Learning Choice Academy - East County	San Diego	$250,000
TOTAL:			**$2,850,000**