M E M O R A N D U M **Staff Summary No. 8**

Date: June 25, 2020

To: Members of the California School Finance Authority

From: Katrina M. Johantgen, Executive Director

Subject: Resolution No. 20-19 – Approval of the Charter School Revolving Loan Fund Program Recommendations and Amounts (Action Item)

Overview: In December 2019, the California School Finance Authority (Authority) opened the Charter School 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.

Staff reviewed two tiers of applications: (1) 13 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 13 loans for board approval for the P1 schools listed in Exhibit A of Resolution No. 20-19 at the Authority's June 25, 2020 meeting.

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 previously brought 11 P2 schools to the Board and received approval for loan proceeds, in advance of the P1 schools, as P2 schools had 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. Since there is ample funding for P2 and P1 schools it was decided to reverse the order in which loan were awarded since the Authority started administering this Program.

Staff Review Process: 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 may continue to be extended to schools in need. 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.

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;
   - Reasonableness of budget assumptions (staff applied uniform Local Control Funding Formula (LCFF) funding rates to all applicants);

[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."

- 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 rates default risk while using its financial analysis decisions for each school by using an internal point system. Staff utilizes three DSC metrics: (1) total state aid subject to CSFA intercept; (2) net revenues; and (3) net revenues plus beginning net assets. Threshold levels are established 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 may also reduce loan amounts for any applicants that does not otherwise meet the threshold underwriting DSC standards, with a minimum $100,000 loan, no loan reductions were made for this round.

The financial model also determines the risk profile of an applicant with a passing score. Applicants with scores ranging from 50.0 to 75.0 are viewed as "high risk", while applicants with scores ranging from 75.1 to 90.0 are deemed "medium risk", and applicants with scores ranging from 90.1 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 bases the recommended loan amount and repayment period on each school's remaining charter term. Additionally, staff recommends each applicant be awarded a loan that may be repaid based on the results of the financial analysis described above.

6. **Disbursements:** In an effort to reduce losses to the Program, staff will: (1) continue the current frequency of attendance monitoring in the year of loan award, and (2) limit loan disbursements to borrowers with attendance certified at levels consistent with previously submitted projections. For lower risk loan approvals, 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 medium or higher risk loan approvals, 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, as previously mentioned in December and the third would be in 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 fully meet the following criteria, once approved by the Authority's 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. 20-19, approving Revolving Loan Fund Program recommendations and amounts to the schools listed in the attached Exhibit A – *Charter School Revolving Loan Fund Program P1 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
P1 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	Citizens of the World Charter School 5	Los Angeles	$250,000
2	Clovis Global Academy	Fresno	$250,000
3	El Rio Community School	Los Angeles	$250,000
4	Endeavor Charter School	Fresno	$250,000
5	Equitas Academy 6	Los Angeles	$250,000
6	Future Is Now Preparatory	Los Angeles	$250,000
7	Invictus Leadership Academy	Los Angeles	$250,000
8	OCASA College Prep	Orange	$250,000
9	Pinecrest Expedition Academy	Tuolumne	$250,000
10	South LA College Prep (aka Ednovate College Prep 7)	Los Angeles	$250,000
11	T.I.M.E. Community Schools	Los Angeles	$250,000
12	Voices College-Bound Language Academy at Stockton	San Joaquin	$250,000
13	We the People	Los Angeles	$250,000
TOTAL:			**$3,250,000**