

MEMORANDUM

Staff Summary No. 5

Date: May 11, 2011

To: Members of the California School Finance Authority

From: Katrina M. Johantgen, Executive Director

Subject: Resolution No. 11-26 Authorizing the Allocation of Qualified School Construction Bond Borrowing Authority to Perris Union High School District on behalf of the California Military Institute, in an amount not to exceed \$2,100,000 Under the Charter School QSCB Program Parameters, and Authorizing the Taking of Necessary Actions in Connection Therewith

The American Recovery and Reinvestment Act of 2009 (ARRA) provides funding for the new construction or renovation of school facilities through the use of Qualified School Construction Bonds (QSCBs).

Since 2009, California received more than \$1.42 billion in “volume cap” allocation (not including direct allocations to large local educational agencies) for the issuance of QSCBs. Of this amount, approximately \$141 million has been reserved for use by charter schools through the issuance of conduit revenue bonds by the California School Finance Authority (Authority) which will be designated as QSCBs.

At the October 23, 2009 CSFA Board Meeting, the board allocated \$3 million to Perris Union High School District (PUHSD) on behalf of the California Military Institute to finance the construction of two school sites. The QSCB allocation granted at the October 2009 board meeting expired on March 31, 2010. At its July 14, 2010 board meeting, the Authority board adopted an open application process for its QSCB charter school bond allocation. The District recently submitted a new application for QSCB borrowing authority. The proceeds of the QSCBs will be used for the California Military Institute’s current facilities. The project will consist of the construction of a 20,000 square foot building that will provide nine new teaching stations along with educational support facilities. The new teaching stations will accommodate science, technology, health/physical education, and core curriculum subject areas.

During our application review process, the following information was disclosed.

PUHSD is currently in a legal dispute with the California Department of Education regarding funding levels paid to another PUHSD charter, CHOICE 2000. Choice 2000 is an on-line school, and requires students to participate daily with other seat programs, thus meeting the daily and annual instructional-minutes requirement. In 2006, Choice 2000 received an audit finding for 05-06 which disallowed all ADA funding (\$1.2 million) based on a new audit guide revision that states that all non-classroom based charter schools must comply with Independent Study laws. The auditor confirmed that Choice 2000 complied with the seating requirement; however the auditor was instructed by CDE to disallow the funding due to the lack of independent study policies and contracts in place. The district appealed to the Education Audit Appeals Panel (EAAP). An administrative law judge issued a proposed decision ruling in favor of Choice 2000. EAAP rejected this recommendation and has

ordered the repayment of the \$1.2 million. Litigation is still pending and the next scheduled hearing is set for June 1, 2011. All parties continue to discuss a possible resolution out of court with PUHSD hoping for no revenue to be repaid. Depending on the outcome of the litigation, PUHSD may also challenge in court the other four years of audit exceptions, which totals \$5.7 million. The last updated status provided from PUHSD, the issue was on hold at CDE. Staff will continue to monitor this issue and assess any risks that could have an impact on PUHSD's financial viability and ability to issue bonds.

Given the potential credit implications of the issue noted above, staff is recommending a conditional allocation of QSCB borrowing authority to PUHSD on behalf of CMI. PUHSD must either: 1) structure a financing that achieves an "A" rating and that is sold through a public offered negotiated bond sale; or 2) the bonds are privately placed with a single investor (most likely a financial institution) that agrees to hold all of the unrated bonds until maturity. It has yet to be determined which issuer will serve as issuer of the bonds on behalf of CMI – the Authority, PUHSD, or the District financing corporation.

Staff recommends that the Board adopt Resolution 11-26, containing the conditions described above, and approving the allocation of \$2.1 million of the QSCB borrowing authority to Perris Union High School District on behalf of the California Military Institute located in Perris, California.