

**CHARTER SCHOOL FACILITIES PROGRAM
PROP 1D 2010 FUNDING ROUND
STAFF SUMMARY REPORT – MARCH 2012**

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:	2840 W First 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:	2014-15

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:	\$3,036,122
State Apportionment (50% Project Cost):	\$1,518,061
Lump Sum Contribution:	\$0
Total CSFP Financed Amount:	\$1,518,061
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:	2015-16

Staff Recommendation: Staff recommends that the California School Finance Authority (CSFA) Board determine that the 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 recommendation is contingent upon MERF electing to have its CSFP payments intercepted at the state level, pursuant to Sections 17199.4 and 17078.57(a)(1)(A) of the Education Code. 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 the 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 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 recommendation is contingent upon MERF electing to have its CSFP payments intercepted at the state level, pursuant to Sections 17199.4 and 17078.57(a)(1)(A) of the Education Code. 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: PTS-SA under the Program’s 2011 Lottery Funding Round, was found financially sound for its request for an advance of \$1,481,396 for Design and is now requesting \$2,600,000 for site acquisition. In addition, MERF was notified by OPSC, for an approved application on behalf of Magnolia Science Academy-San Diego (MSA-SD) in the amount of \$3,036,123, and was subsequently found financially sound by the CSFA Board on June 27, 2011. MERF, on behalf of MSA-SD, is now requesting an advance in the amount of \$303,612 for Design costs. 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 was evaluated when conducting the 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 have met all Program eligibility criteria: 1) charters are in place; 2) PTS-SA and MSA-SD have been in operation for at least two years and 3) PTS-SA and MSA-SD are in compliance with the terms of their respective charters and in good standing with their respective chartering entities.

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Demographic Information	<ol style="list-style-type: none"> 1. PTS-SA currently serves 134 students in grades 6 through 10, and projects enrollment to increase to 548 students in 2014-15 (year of project occupancy) and to 671 students in grades 6-12 in 2017-18. 2. MSA-SD currently serves 308 students in grades 6 through 8, and projects enrollment to increase to 575 students in 2015-16 (year of project occupancy) and remain consistent at 575 students through 2017-18. 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 3,063 students in twelve schools. MERF achieved an aggregate ADA rate of 96% in 2009-10, 2010-11, and 2011-12 (P1 Reports).
Debt Service Coverage	<p>MERF's projected debt service coverage ratios of 2,018.4% in 2015-16 (PTS-SA Only), 1,802.8% in 2016-17 and 1,876.6% in 2017-18 (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 (8,392 students by 2016-17; 174% growth from 3,063 students in 2011-12). MERF's enrollment must be approximately 6,325 students in 2016-17 to generate projected debt service coverage of at least 100.0%, which represents a 24.6% margin of error.</p>
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 1.0% of revenues in 2016-17 and 2017-18. 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 2010-11 of \$1.95 million represented 9.5% of total expenses, which exceeds the preferred minimum of 5.0%.
Student Performance	<p>PTS-SA met all AYP criteria in 2009-10, and scored a base API of 852. However, PTS-SA did not meet AYP in 2010-11 and the API score dropped to 777. MSA-SD has not met AYP for the last four years of testing. MSA-SD has achieved API growth scores of 803, 804, 818, and 814 for 2007-08 through 2010-11, respectively.</p>

Program Eligibility: On March 4, 2012, 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 1, 2012, 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 a 2.6 acre parcel at the address of 2840 W First Street, Santa Ana. The new facility will consist of a brand new two story building which contains 5 (five) standard science labs stations, twenty six (26) state of the art classrooms, Gym, meeting rooms, small lunch preparation room, and is anticipated to be completed by the beginning of the 2014-15 school year, per the schedule of MERF. The school is anticipated to have capacity for 675-700 students in grades 6-12. MERF is currently going through the CDE site approval process. PTS-SA was given a preliminary apportionment of \$17,413,956 for this project, of which they received an advance apportionment in the amount of \$1,481,396 for design in January 2012. MERF is currently requesting an advance of \$2.6 million for site acquisition.

MSA-SD is requesting \$303,612 for design services, and is proposing to expand the current campus by adding DSA approved bungalows on the 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 adding six DSA approved regular classrooms, one DSA approved science lab, one DSA approved computer lab and a DSA approved boys/girls restroom, thus increasing the enrollment capacity of the facility by 270 students. The school will be serving approximately 525-575 students, enrolled in grades 6 through 9. The project for MSA-SD has been significantly reduced, compared to their original request, due to the availability of funding that OPSC currently had 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 it has an enrollment of 134 students in grades 6-10, and anticipates to expand to grades 6-12 (chartered for grades 6-12).

MSA-SD commenced instructional operations in 2005-06 with 81 students in grade 6 and it currently serves 308 students in grades 6-8 (chartered for grades 6-9).

PTS-SA and MSA-SD operate as independent charter schools under the auspices of MERF, an charter management organization (CMO) (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.

Charter 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 CMO 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 CMO responsible for oversight and development, and prior to this time, the two schools in operation, MSA-1 and MSA-SD, operated independent of an CMO, 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 MSA-SD 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.

CMO 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 the 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	2012-2017
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 CMO 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 favorably, 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. Nine of MERF’s twelve schools that have been in operations for two or more years have available API, AYP, and State/Similar Schools ranking data, while the remaining three schools, MSA-7, MSA-8, and MSA-Santa Clara, have no API and school ranking data; however AYP scores have been posted for these schools. 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.

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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	2010-11
MSA-1	749/Yes	765/Yes	767/No	781/Yes	788/Yes	800/Yes	807/N/A
MSA-2				703/NA	697/No	745/Yes	759/Yes
MSA-3					742/NA	777/Yes	754/No
MSA-4					748/NA	753/Yes	794/Yes
MSA-5					814/NA	847/Yes	786/No
MSA-6						842/NA	817/NA
MSA-SD		739/NA	810/Yes	803/NA	797/No	818/Yes	814/N/A
PTS-Orange						825/NA	829/NA
PTS-SA						852/NA	777/NA
MSA-SC							N/A
MSA-7							N/A
MSA-8 Bell							N/A

Magnolia Education and Science Foundation API Base Rank: Statewide/Similar Schools							
School	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
MSA-1		7/10	7/10	7/10	7/10	7/10	8/10
MSA-2					4*/N/A	3/3	4/8
MSA-3						5/7	6/10
MSA-4						5*/N/A	N/A
MSA-5						8*/N/A	8/10
MSA-6							N/A
MSA-SD			5*/N/A	8/10	8/3	7/2	7/4
PTS-Orange							N/A
PTS-SA							N/A
MSA-SC							N/A
MSA-7							N/A
MSA-8 Bell							N/A

Magnolia Education and Science Foundation Met All AYP Criteria							
School	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
MSA-1	Yes	Yes	Yes	Yes	Yes	No	No
MSA-2				Yes	Yes	No	No
MSA-3					No	No	No
MSA-4					Yes	No	Yes
MSA-5					Yes	No	No
MSA-6						Yes	No
MSA-SD		Yes	Yes	No	No	No	No
PTS-Orange						Yes	No
PTS-SA						Yes	No
MSA-SC							Yes
MSA-7							Yes
MSA-8 Bell							No

Among the twelve schools that were in operations for the last school year, only three of the schools met all AYP criteria for the most recent reported year, 2010-11, 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. When staff inquired with MERF in regards to the PI status at MSA-SD, and what steps the organization is taking to remedy the status, they stated the following: “The Magnolia Educational and Research Foundation board discusses each school’s academic performance at every board meeting, and staff recommends policies to improve academic performance to the board for approval. In August 2011, the board approved a system-wide, school-specific academic improvement plan focusing on the expected school wide learning results and increased academic rigor, college readiness, STEM focus, and school safety. Driving the development of this improvement plan’s goals was a thorough analysis of academic data from the California Standardized Achievement Tests (CST), MAP testing, and academic grades. Data was disaggregated by grade, subgroup, and classroom, and by CST cluster analysis. Subject area data teams at Magnolia Science Academy San Diego have been established to support teachers’ understanding and use of student performance indicators to drive instructional improvements.”

Of the schools that had scores below 800, two schools met their API growth targets with four of the schools having achieved API growth scores of greater than 800, and two schools not meeting the growth goal. Staff inquired with MERF in regards to the number of schools meeting API growth, including a 77 point decrease in API for PTS-SA, MERF stated, “It is important to note that during the past two years, Magnolia has doubled the number of schools it operates, expanding to a total of twelve schools. Eight schools added additional grade levels, and system wide, 500 additional students were added to Magnolia student rosters in 2010-11. Four schools (including PTS-Santa Ana) more than doubled their enrollments over the preceding year. Such large increases in enrollment have impacted the API scores at these schools. Ours was an ambitious growth agenda under ordinary circumstances. Coupled with the onerous reductions and deferrals of state and federal funding, we recognize that the times call for us to step up our game to deal with the new “normal” – greater austerity amidst increasing need and demand. Until all our schools have reached their full grade span capacity and maximum enrollment, we must combat the impact of growth on our API through more intense data analysis to guide our decisions and ensure that we are reaching every student immediately and effectively. To this end, we have launched the following initiatives to ensure that we maintain our track record of providing a high quality, comprehensive education program to our students: Our new Chief Academic Officer has been promoted from his position as principal at our flagship school in Reseda. Mr. Gurler will be leading

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

our efforts to use data to guide all of our education program decisions from the teacher level to the central office. We have launched a layered professional development program to train teachers in the use of data to improve curriculum and instruction and to target individual students for intervention and assistance. We have aligned our teacher recruitment, training, supervision and evaluation systems to ensure that data drives all these components of effective teaching. We have paused our school expansion plans for this year to ensure that all existing schools reach a level of stability and consistency in academic achievement. We refined our vision and mission to better guide our work and measure our success. Rather than our previous and narrower focus on preparing students for career paths in math and science, we have expanded our vision to develop scientific thinkers prepared to be contributing citizens in a global society.”

With respect to rankings, MSA-1 has shown consistently high rankings for the past six years of 7 or 8 statewide and 10 against similar schools (10 = best). MSA-SD achieved a statewide ranking of 7 and a similar schools ranking of 4 in the 2010-11 school year.

Enrollment and Retention Rates: PTS-SA currently has 134 students in grades 6 through 10. Through the addition of grades 11 and 12 and with the expansion of class sizes, MERF is projecting PTS-SA’s enrollment to grow to 548 students in 2014-15 (first year of project occupancy) and to 672 students in grades 6-12 in 2015-16 (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 575 students in grades 6-9 in 2015-16 (first year of project occupancy) and to remain stable at that level through 2017-18 (first two years of CSFP payments).

MERF Enrollment and Retention Rates: The tables below depict MERF’s historical, current, and projected enrollment by school (through 2017-18). 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	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
MSA-1	419	478	499	506	525	525	525	525	525	525
MSA-2	157	227	227	312	375	550	550	550	550	550
MSA-3	228	151	257	274	375	525	600	600	600	600
MSA-4	61	98	105	163	350	525	600	600	600	600
MSA-5	63	115	156	212	350	525	650	650	650	650
MSA-6		74	168	156	325	500	625	625	625	625
MSA-7			96	136	324	424	596	596	596	596
MSA-8			441	482	495	495	495	495	495	495
MSA-SD	274	328	308	308	360	450	525	575	575	575
MSA-SC			102	234	450	550	600	600	600	600
PTS-Orange		67	151	146	300	425	475	600	675	675
PTS-SA		63	98	134	200	224	548	672	671	671
Projected - 1							275	325	490	565
Projected - 2								275	390	390
Projected - 3								225	350	425
Totals	1202	1601	2608	3063	4429	5718	7064	7913	8392	8542

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 3,063 students in twelve schools. In addition, MERF has achieved an aggregate ADA rate of 96% for school years 2007-08 through 2010-11 and 96% for the 2010-11 school year (P1 Reports). For the twelve schools currently in operation and the projected opening of three more schools, MERF is projecting the following enrollment growth: 3,063 students for the current 2011-12 academic year; 4,429 students for 2012-13 (45% growth from prior year); 5,718 students for 2013-14 (29% growth from prior year), 7,064 for 2014-15 (24% growth from prior year), 7,913 for 2015-16 (12% growth from prior year), 8,392 for 2016-17 (6% growth from prior year), and 8,542 for 2017-18 (2% growth from prior year and 279% growth from current year).

Year to Year Retention Rates					
School	2007-08	2008-09	2009-10	2010-11	2011-12
MSA-1	73%	83%	90%	99%	93%
MSA-2		87%	74%	90%	86%
MSA-3			68%	81%	78%
MSA-4			85%	74%	83%
MSA-5			63%	75%	79%
MSA-6				97%	81%
MSA-7					86%
MSA-8					92%
MSA-SD	84%	76%	91%	93%	72%
MSA-SC					90%
PTS-SA				95%	95%
PTS-Orange				100%	100%

With respect to the year-to-year retention rates, for the most recent year, five of the twelve schools with returning students showed retention rates of 90% or more, with all rates averaging 86%.

Financial Analysis: Staff’s evaluation of MERF’s financial performance is based on review of the following documents: (1) MERF’s audited financial statements for 2005-06 through 2010-11; (2) MERF’s approved budget for 2011-12; (3) MERF’s budget projections for 2012-13 through 2017-18; and (4) MERF’s current enrollment for 2011-12 as well as projected average annual enrollment for 2012-13 through 2017-18.

MERF’s financial projections are based upon the following assumptions: (1) occupancy of the constructed CSFP project in 2014-15 for PTS-SA and 2015-16 for MSA-SD; (2) increases in enrollment as described above under the Enrollment Trends and Projections section; (3) 2011-12 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 96%, which is consistent with MERF’s historical performance; (5) revenue growth (cost of living adjustments) on charter school block grant of 0% for 2012-13 through 2014-15, and 2.0% for 2015-16 through 2017-18; (6) and cost of living adjustments for the expense categories are 2.0% for the fiscal years of 2012-13 through 2017-18.

Highlighted in this section are financial data and credit indicators used to evaluate MERF’s ability to meet its CSFP obligations for its projects funded by Propositions 1D. Staff’s financial analysis is

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based on information for MERF as an organization and not for each applicant school on a stand-alone basis. Please note that the revenue, expenditure and changes to net assets recorded in financial audits and provided in MERF's financial projections have been modified by staff, where necessary, to include capital outlays, operating leases and repayment of debt and other significant obligations, and to exclude non-cash items such as depreciation.

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	Projected FY2015-16	Projected FY2016-17	Projected FY2017-18
ENROLLMENT PROJECTIONS											
Enrollment	709	1,202	1,601	2,608	3,063	4,429	5,718	7,064	7,913	8,392	8,542
Average Daily Attendance	685	1,155	1,541	2,505	2,928	4,252	5,489	6,781	7,596	8,056	8,200
Average Daily Attendance (%)	97%	96%	96%	96%	96%	96%	96%	96%	96%	96%	96%
FINANCIAL PROJECTIONS											
Total Revenues Available for CSFP Lease Payment	\$ 6,222,419	\$ 11,520,224	\$ 14,346,862	\$ 20,865,544	\$ 24,577,229	\$ 35,221,516	\$ 45,787,083	\$ 56,710,982	\$ 64,577,099	\$ 69,974,565	\$ 72,907,751
Total Expenses Paid Before CSFP Lease Payment	6,139,043	10,621,556	13,315,319	20,557,865	21,892,796	32,463,575	42,754,632	52,621,229	56,120,921	61,249,052	63,965,233
Accounting Adjustments	207,367	205,874	140,929	169,099	270,000	510,000	679,000	847,000	510,000	679,000	847,000
Net Revenues Available for CSFP Lease Payment	\$ 290,743	\$ 1,104,542	\$ 1,172,472	\$ 476,778	\$ 2,954,433	\$ 3,267,941	\$ 3,711,451	\$ 4,936,753	\$ 8,966,178	\$ 9,404,513	\$ 9,789,518
CSFP Lease Payment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 444,224	\$ 521,674	\$ 521,674
Net Revenues After CSFP Lease Payment	\$ 290,743	\$ 1,104,542	\$ 1,172,472	\$ 476,778	\$ 2,954,433	\$ 3,267,941	\$ 3,711,451	\$ 4,936,753	\$ 8,521,954	\$ 8,882,839	\$ 9,267,844
FINANCIAL INDICATORS											
Net Revenues Available for CSFP Lease Payment	\$ 290,743	\$ 1,104,542	\$ 1,172,472	\$ 476,778	\$ 2,954,433	\$ 3,267,941	\$ 3,711,451	\$ 4,936,753	\$ 8,966,178	\$ 9,404,513	\$ 9,789,518
Debt Service Coverage by Net Revenues	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	2018.4%	1802.8%	1876.6%
Contributions	\$ 93,666	\$ 111,840	\$ 57,565	\$ 51,917	\$ 410,642	\$ 485,676	\$ 557,503	\$ 632,183	\$ 694,758	\$ 731,724	\$ 751,057
Debt Service Coverage by Net Revenues (w/out Contributions)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	1862.0%	1662.5%	1732.6%
CSFP Lease Payment / Revenues	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	0.7%	0.7%
Contributions / Revenues	1.5%	1.0%	0.4%	0.2%	1.7%	1.4%	1.2%	1.1%	1.1%	1.0%	1.0%
Net Revenues After CSFP Lease Payment / Revenues	4.7%	9.6%	8.2%	2.3%	12.0%	9.3%	8.1%	8.7%	13.2%	12.7%	12.7%
Revenues / ADA	\$ 9,085	\$ 9,975	\$ 9,310	\$ 8,330	\$ 8,394	\$ 8,284	\$ 8,341	\$ 8,363	\$ 8,501	\$ 8,686	\$ 8,891
Expenses / ADA	\$ 8,964	\$ 9,197	\$ 8,641	\$ 8,207	\$ 7,477	\$ 7,635	\$ 7,789	\$ 7,760	\$ 7,446	\$ 7,667	\$ 7,864
Surplus (Deficit) / ADA	\$ 122	\$ 778	\$ 669	\$ 123	\$ 917	\$ 649	\$ 552	\$ 603	\$ 1,055	\$ 1,018	\$ 1,027
Net Working Capital	\$ (265,795)	\$ 608,297	\$ 2,060,059	\$ 1,945,533	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Net Working Capital / Expenses	N/A	5.7%	15.5%	9.5%	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Contributions: MERF's contributions over the last three years were as follows: \$93,666 for 2007-08, \$111,840 for 2008-09, \$57,565 for 2009-10, and \$51,917 for 2010-11. MERF, however, anticipates substantially higher contributions in budgeted and projected years, averaging \$609,078 in contributions annually. Staff notes that projected contribution levels are optimistic given the historical trend.

Long-Term Liabilities: At June 30, 2011, MERF had outstanding long-term liabilities of \$1.63 million. These debt obligations took the forms of two capital leases (\$11,824); eight California Department of Education loans totaling \$818,231, and with interest rates ranging from .53% to 1.57%; one line of credit with a local bank (\$745,698 at 4.25%); one Promissory Note (\$32,278 at 1.44%); and one unsecured loan (\$33,600 at 7.33%). 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 due to seniority of the previous obligations. Of these liabilities, \$1,117,307 is due prior to June 30, 2012. Four of these obligations are in connection with PTS-SA and MSA-SD with the rest attributable to MSA-1, MSA-2, MSA-3, MSA-4, MSA-5, MSA-6, PTS-Orangevale, and MERF.

Items 4.14 and 5.2 – Magnolia Educational and Research Foundation

Magnolia Educational and Research Foundation						
School	2010-2011	2011-2012	2012-2013	2013-2014	2014-2015	2015-2016
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	\$ 20,082
MSA-5	\$ 20,313	\$ 20,390	\$ 20,287	\$ 20,185	\$ 20,082	\$ 20,082
MSA-6	\$ 20,313	\$ 20,390	\$ 20,287	\$ 20,185	\$ 20,082	\$ 20,082
PTS-SA	\$ 20,313	\$ 20,390	\$ 20,287	\$ 20,185	\$ 20,082	\$ 20,082
TOTAL	\$ 197,509	\$ 196,254	\$ 144,405	\$ 80,740	\$ 80,328	\$ 80,328

School Facilities – MERF anticipates operating 15 charter schools with a projected enrollment of 7,913 students by 2015-16. 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 aggregate rental payments required under the terms of their operating leases ranges from a high of \$921,242 in 2011-12 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: \$2.13 million (2011-12), \$3.47 million (2012-13), \$4.63 million (2013-14), \$5.55 million (2014-15), \$5.99 million (2015-16), \$6.03 million (2016-17), and \$6.05 million (2017-18). These estimated expenses are equivalent to an average of 9% 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.

Items 4.14 and 5.2 – Magnolia Educational and Research Foundation

Magnolia Education and Science Foundation Met All AYP Criteria								
School	2011-12	2012-13	2013-14	2014-15	2015-16	2017-18	2018-19	Type of Lease
MERF	\$ 62,500	\$ 62,500	\$ 62,500	\$ 62,500	\$ 62,500	\$ 62,500	\$ 62,500	Lease
MSA-1	\$ 445,500	\$ 415,000	\$ 515,000	\$ 515,000	\$ 535,000	\$ 545,000	\$ 545,000	Lease
MSA-2	\$ 150,000	\$ 150,000	\$ 150,000	\$ 150,000	\$ 250,000	\$ 250,000	\$ 250,000	Prop 39/Mult Year
MSA-3	\$ 110,000	\$ 720,000	\$ 720,000	\$ 720,000	\$ 720,000	\$ 720,000	\$ 720,000	Prop 39
MSA-4	\$ 68,000	\$ 247,500	\$ 382,500	\$ 540,000	\$ 600,000	\$ 600,000	\$ 600,000	Prop 39
MSA-5	\$ 80,000	\$ 247,500	\$ 382,500	\$ 540,000	\$ 600,000	\$ 600,000	\$ 600,000	Prop 39
MSA-6	\$ 108,000	\$ 247,500	\$ 382,500	\$ 540,000	\$ 600,000	\$ 600,000	\$ 600,000	Lease
MSA-7	\$ 168,000	\$ 216,000	\$ 382,500	\$ 540,000	\$ 600,000	\$ 600,000	\$ 600,000	Lease
MSA-8	\$ 200,000	\$ 200,000	\$ 200,000	\$ 200,000	\$ 220,000	\$ 250,000	\$ 250,000	Public School Choice
MSA-SD	\$ 60,000	\$ 60,000	\$ 60,000	\$ 60,000	\$ -	\$ 77,450	\$ 77,450	Lease
MSA-SC	\$ 204,000	\$ 450,000	\$ 450,000	\$ 450,000	\$ 450,000	\$ 450,000	\$ 450,000	Lease
PTS-OV	\$ 264,000	\$ 264,000	\$ 350,500	\$ 350,500	\$ 350,000	\$ 350,000	\$ 350,000	Lease
PTS-SA	\$ 210,000	\$ 210,000	\$ 210,000	\$ -	\$ 444,224	\$ 444,224	\$ 444,224	Lease
Proj.1	-	\$ 247,500	\$ 292,500	\$ 350,000	\$ 350,000	\$ 350,000	\$ 375,000	Lease
Proj.2	-	-	\$ 244,800	\$ 350,000	\$ 350,000	\$ 350,000	\$ 350,000	Lease
Proj.3	-	-	\$ 112,500	\$ 243,000	\$ 300,000	\$ 300,000	\$ 300,000	Lease
TOTALS	\$2,130,000	\$3,737,500	\$4,897,800	\$5,611,000	\$6,431,724	\$6,549,174	\$6,574,174	

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. In 2010-11, MERF increased net assets by \$476,778, including contributions of \$51,917.

On total revenues and expenses of \$24.58 million and \$21.89 million, MERF's second interim budget estimate for 2011-12 indicates increased net assets by \$2.68 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 45% to 4,429 students next year (2012-13), MERF projects increasing total revenues to \$35.22 million, and expenses to \$32.46 million, for a net increase of \$2.76 million. In the first year of the CSFP project occupancy for PTS-SA, 2014-15, MERF projects an enrollment of 7,064 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 \$4.09 million on \$56.71 million in revenues and \$52.62 million in expenses. In the first year of the CSFP project occupancy for MSA-SD, 2015-16, MERF's projected enrollment growth is expected to continue with 7,913 students, resulting in an increase to net assets of \$9.60 million before payment of the expected CSFP lease obligations. With student enrollment of 8,392 students expected for 2016-17, total revenues of \$69.97 million would exceed total expenses of \$61.25 million by \$8.73 million, before CSFP lease payments are expensed. For 2017-18, student enrollment is projected to increase to 8,542, with total revenues of \$72.91 million, and total expenses of \$63.97 million, thus increasing the net assets by \$8.94 million before payment of CSFP obligations.

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 \$20,450,078, MERF's combined annual CSFP payment (two projects) would be \$521,674 beginning in 2016-17. MERF's projected net revenues of \$9.40 million for 2016-17 would provide debt service coverage of 1,802.8%, while

the projected net revenues of \$9.79 million would result in debt service coverage of 1,876.6% for 2017-18. However, MERF's ability to meet the minimum debt service coverage is highly dependent on MERF realizing projected enrollment at its existing schools (8,392 students by 2016-17; 174% growth from 3,063 students in 2011-12). MERF's enrollment must be approximately 6,325 students in 2016-17 to generate projected debt service coverage of at least 100.0%, which represents an 24.6% margin of error.

Liquidity: At June 30, 2011, MERF reported holding \$387,230 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, 2009-10, and 2010-11 was (\$265,795), \$608,297, \$2.06 million, and \$1.95 million respectively, or less than 0%, 5.7%, 15.5%, and 9.5% 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 2010-11 is sufficiently higher than the 5% staff recommends.

Strengths, Weaknesses and Mitigants

- + MERF's projected debt service coverage ratios of 2,018.4% in 2015-16 (PTS-SA Only), 1,802.8% in 2016-17 and 1,876.6% in 2017-18 (both CSFP payments) exceed the minimum requirement of 100.0%
- + 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 3,063 students at twelve schools. In addition, MERF achieved an aggregate ADA rate of 96% between 2007-08 and 2011-12.
- + This recommendation is contingent upon MERF electing to have its CSFP payments intercepted at the state level, pursuant to Sections 17199.4 and 17078.57(a)(1)(A) of the Education Code.
- +/- 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 adopt Resolution 12-09 which determines that the 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 recommendation is contingent

upon MERF electing to have its CSFP payments intercepted at the state level, pursuant to Sections 17199.4 and 17078.57(a)(1)(A) of the Education Code. 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 adopt Resolution 12-08 which determines that the 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 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 recommendation is contingent upon MERF electing to have its CSFP payments intercepted at the state level, pursuant to Sections 17199.4 and 17078.57(a)(1)(A) of the Education Code. Staff recommends that the CSFA Board direct staff to notify the Office of Public School Construction and the State Allocation Board regarding this determination.