

**CHARTER SCHOOL FACILITIES PROGRAM
PROP 1D 2010 FUNDING ROUND
STAFF SUMMARY REPORT – AUGUST 2013**

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:	2.00%
Estimated Annual CSFP Payment:	\$67,781
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 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: As a result of rescissions in the Program that resulted in the 2011 Lottery Funding Round under Proposition 1D, 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. On July 12, 2012, the State Allocation Board approved a preliminary apportionment in the amount of \$3,036,123. On March 14, 2012, MERF, on behalf of MSA-SD was found financially sound for Advance Apportionment for design in the amount of \$303,612. However, due to MSA-SD's need to establish itself on a district site for purposes of the new construction, MSA-SD did not receive its Advance release of funds at that time. As such, MERF, on behalf of MSA-SD, is now again requesting an Advance Apportionment for design in the same amount. As MERF is the applicant and financial obligor, 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 MSA-SD. Detailed information is contained in the body of the report.

Criteria	Comments
Eligibility Criteria	MSA-SD have met all Program eligibility criteria: 1) charter in place; 2) MSA-SD has been in operation for at least two years and 3) MSA-SD is in compliance with the terms of their charter and in good standing with their chartering entity.
Demographic Information	<ol style="list-style-type: none"> 1. MSA-SD currently serves 335 students in grades 6 through 8, and projects enrollment to increase to 660 students in 2016-17 (first year of project occupancy) and 2017-18. 2. MERF achieved enrollment growth from 188 students in one school (MSA-1) in 2002-03 to 695 students in three schools in 2007-08 to its 2012-13 enrollment of 3,687 students in twelve schools. MERF achieved an aggregate ADA rate of 96% from 2008-09 through 2012-13.
Debt Service Coverage	MERF's projected debt service coverage ratios of 2,490% in 2016-17 and 2,482% in 2017-18 exceed the minimum requirement of 100.0% by a wide margin. 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; 132% growth from 3,687 students in 2012-13). MERF's enrollment must be approximately 5,500 students in 2016-17 and 2017-18 to generate projected debt service coverage of at least 100.0%.
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 the CSFP payment. 3. Net working capital for 2011-12 of \$2.65 million represented 10.3% of total expenses, which exceeds the preferred minimum of 5.0%.
Student Performance	MSA-SD met all AYP in 2011-12 after not meeting all AYP in the previous four years. MSA-SD has shown gradual improvement in API growth scores, achieving scores of 797, 818, 814, and 865 for 2008-09 through 2011-12, respectively.

Program Eligibility: On July 23, 2013, 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 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: 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 660 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: MSA-SD commenced instructional operations in 2005-06 with 81 students in grade 6, and in 2012-13, it served 335 students in grades 6-8 (chartered for grades 6-9). MSA-SD operates as an independent charter school under the auspices of MERF, a charter management organization (CMO) (described below). Through its management staff and Board of Directors, MERF is largely responsible for developing 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 nine have begun instructional operations since 2008-09. The three schools that have been in operations for six or more years are MSA-1, 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 the 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.

Noah Stevens was recently appointed as Principal of MSA-SD effective July 2013. Prior to this position, Mr. Stevens served as Dean of Students and Athletic Director at MSA-SD (2010-13), and physical education teacher (2007-10). Mr. Stevens holds an M.S. from National University in multi-cultural education as well as Single Subject Credential from the same university.

CMO Management: Mehmet Argin has served as MERF's Chief Executive Officer since July 2012. Prior to this role, Mr. Argin served as Chief Executive Officer of Sonoran Schools (formerly Daisy Education Foundation) (2010-12), Principal at Sonoran Science Academy (2009-10 and 2006-08), and Principal at Paragon Science Academy (2008-09). Mr. Argin holds a Ph.D. in Electrical Engineering from Arizona State University.

Mr. Ismail Hakki Karaman was recently appointed as MERF's Chief Operating Officer beginning June 2013. Prior to this position, Mr. Karaman served as Principal of MSA-SD (2010-13). 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. 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: 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 Expiration
Umit Yapanel, Board President	Project Engineer at Audience, Inc.	2012-17
Saken Sherkhanov, Secretary	Ph.D. Candidate at UCLA (Chemistry and Biochemistry)	11/13/08 – 11/12/13
Mustafa Kaynak, Member	Electronics Engineer	2009-14
Francisco Huidobro	Self-employed businessman	2012-17
Bayram Yenikaya, Member	Consultant	2009-14
Guilbert Hentschke, Member	Professor	2010-15
Noel Russel-Uterburger	Comptroller, Independent Contractor	2012-17

Management Experience for Schools Open Less than Two Years: Not applicable. MERF, as CMO to MSA-SD, 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.

MSA-SD has four years of reported API and AYP results, allowing staff to assess MSA-SD’s academic improvement, as highlighted in the following table.

Magnolia Science Academy - San Diego	FY 2008/09	FY 2009/10	FY 2010/11	FY 2011/12
ADEQUATE YEARLY PROGRESS (AYP)				
Met All AYP Criteria?	No	No	No	Yes
Criteria Met / Required Criteria	14 / 17	15 / 17	14 / 17	17 / 17
Met API Indicator for AYP?	Yes	Yes	Yes	Yes
Met Graduation Rate?	N/A	N/A	N/A	N/A
ACADEMIC PERFORMANCE INDEX (API)				
Met Schoolwide Growth Target?	No	Yes	Yes	Yes
Met Comparable Improvement Growth Target?	No	Yes	Yes	Yes
Met Both Schoolwide & CI Growth Targets?	No	Yes	Yes	Yes
API Base Statewide Rank (10 = best)	8	7	7	7
API Base Similar Schools Rank (10 = best)	3	2	4	5
School's Actual Growth	-7	22	-3	50
Similar Schools Median of Actual Growth	11	12	4	10
Did School's Growth Exceed Median?	No	Yes	No	Yes

Although MSA-SD did not meet all AYP criteria for three of the past four years, during the most recent year, MSA-SD did meet all AYP criteria. Given that the threshold for meeting all AYP criteria has successively increased over the past five years, staff considers MSA-SD's improvement with AYP to be significant. In addition, MSA-SD has met its API growth target during the past three years with an API growth score of 865 for 2011-12. Based on its API base scores for 2011-12 and 2012-13, MSA-SD has achieved Statewide and Similar Schools rankings of "7" and "5", and "8" and "6" (not in table), respectively. Overall, staff considers MSA-SD's academic performance to be supportive of a recommendation for financial soundness.

Staff also reviewed the historical academic performance data that was available for the 12 MERF schools operating during 2012-13, as shown in the tables below. 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.

Magnolia Education and Science Foundation API Growth Scores/ Met Schoolwide API Growth Target							
School	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
MSA-1	765/Yes	767/No	781/Yes	788/Yes	800/Yes	807/Yes	805/Yes
MSA-2			703/NA	697/No	745/Yes	759/Yes	758/No
MSA-3				742/NA	777/Yes	754/No	785/yes
MSA-4				748/NA	753/Yes	794/Yes	766/No
MSA-5				814/NA	847/Yes	786/No	843/Yes
MSA-6					842/NA	817/Yes	843/Yes
MSA-SD	739/NA	810/Yes	803/NA	797/No	818/Yes	814/Yes	865/Yes
PTS-Orangevale**					825/NA	829/Yes	858/Yes
PTS-SA					852/NA	777/No	839/Yes
MSA-SC						841/NA	895/Yes
MSA-7						855/NA	906/Yes
MSA-8 Bell						650/NA	713/Yes

**ceased operations effective June 30, 2013

With respect to API growth, for the most recent reported years, 2011-12, eight of the 12 schools (66.7%) achieved scores of greater than 800 with none of the schools scoring below 700, and 10 of the 12 schools (83.3%) met their Schoolwide API growth target.

Magnolia Education and Science Foundation API Base Rank: Statewide/Similar Schools								
School	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
MSA-1	7/10	7/10	7/10	7/10	7/10	8/10	8/10	8/10
MSA-2				4*/N/A	3/3	4/8	5/9	4/5
MSA-3					5/7	6/10	6/10	8/10
MSA-4					5*/NA	5*/NA	6/10	4/5
MSA-5					8*/NA	8/10	6/9	7/10
MSA-6						8*/NA	7/6	7/8
MSA-SD		5*/NA	8/10	8/3	7/2	7/4	7/5	8/6
PTS-Orangevale**						8*/NA	7/6	8/3
PTS-SA						8*/NA	5*/NA	7/7
MSA-SC							9*/NA	9/4
MSA-7							8*/NA	9*/NA
MSA-8 Bell							1/1	2/2

* Values with an asterisk denote a ranking that is not numerically significant due to a low number of test participants (<100).

**ceased operations effective June 30, 2013

As shown in the table above regarding MERF's statewide and similar schools rankings (base API scores), during the past three reported years, 2010-11 through 2012-13, the majority of schools had statewide and similar schools rankings of "5" or greater. During 2011-12, eight of nine (88.9%)

of applicable schools had statewide and similar schools rankings of “5” or greater. During 2012-13, seven of 11 applicable schools (63.6%) had both rankings of greater than “5”. Only two of the schools, “PTS-Orangevale” and “MSA-8 Bell”, reflected substandard rankings either statewide or against similar schools, and “PTS-Orangevale” closed its operations on June 30, 2013.

Magnolia Education and Science Foundation Met All AYP Criteria							
School	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
MSA-1	Yes	Yes	Yes	Yes	No	No	No
MSA-2			Yes	Yes	No	No	No
MSA-3				No	No	No	No
MSA-4				Yes	No	Yes	Yes
MSA-5				Yes	No	No	No
MSA-6					Yes	No	No
MSA-SD	Yes	Yes	No	No	No	No	Yes
PTS-Orangevale**					Yes	No	No
PTS-SA					Yes	No	Yes
MSA-SC						Yes	Yes
MSA-7						Yes	Yes
MSA-8 Bell						No	No

**ceased operations effective June 30, 2013

In spite of the increasingly difficult task of meeting all AYP criteria over successive years, among the twelve schools that were in operations for 2011-12, five of the schools met all AYP criteria and three met all AYP criteria during the previous year, 2010-11.

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; 56.8% for 2009-10, 67.6% for 2010-11; 78.4% for 2011-12; and 89.2% for 2012-13. This specific requirement will increase to 100% 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.

Notwithstanding that MSA-SD met its AYP criteria for 2012-13, in 2012, staff inquired with MERF in regards to the Program Improvement (PI) status of MSA-SD at that time, and what steps the organization was taking to remedy the status. MERF provided the following response: “The Magnolia Educational and Research Foundation board discusses each school’s academic

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

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."

In 2012, staff inquired with MERF in regards to the number of schools meeting API growth, including a 77 point decrease in API for PTS-SA, and MERF provided the following response: "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 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."

Overall, staff considers MERF's academic performance to be supportive of a recommendation for financial soundness.

Enrollment and Retention Rates: MSA-SD commenced operations with 81 grade-6 students in 2005-06, and has since shown a general growth trend from 274 students in 2008-09 to 335 students in 2012-13 and an anticipated 360 students for 2013-14. MERF is projecting MSA-SD's enrollment to grow to 550 students in grades 6-9 in 2015-16 (first year of project occupancy) and to 660 for the first two year of CSFP payments.

For the past three years, 2010-11 through 2012-13, MSA-SD has shown retention rates of 91%, 72%, and 98%, respectively. For 2011-12 and 2012-13, MSA-SD, had average daily attendance

(ADA) rates of approximately 97% and 95%, respectively, based on CBEDS enrollment. MSA-SD has a current wait list of 150 students.

MERF Enrollment and Retention Rates: The following two tables depict MERF’s historical, current, and projected enrollment by school (through 2017-18) as well as year-to-year retention rates. 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 Educational & Research Foundation								
School	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
MSA-1	499	521	488	550	650	650	650	650
MSA-2	227	300	380	507	629	629	629	629
MSA-3	257	293	379	460	625	625	625	625
MSA-4	105	159	194	240	600	600	600	600
MSA-5	156	211	239	272	450	600	600	600
MSA-6	168	154	136	150	600	600	600	600
MSA-7	96	121	233	292	500	559	596	596
MSA-8	441	481	495	496	650	650	650	650
MSA-SD	308	309	335	360	360	550	660	660
MSA-SC	102	230	525	570	600	600	600	600
PTS-OV*	151	152	138	-	-	-	-	-
PTS-SA	98	145	145	190	600	850	1,000	1,000
Proj. 1	-	-	-	-	450	550	600	600
Proj. 2	-	-	-	-	350	450	582	582
Proj. 3	-	-	-	-	-	-	-	150
Total	2,608	3,076	3,687	4,087	7,064	7,913	8,392	8,542

*ceased operations on June 30, 2013

MERF has achieved consistent enrollment growth from 188 students in one school (MSA-1) in 2002-03, to 695 students in three schools in 2007-08, and to 1,202 students in six schools in 2008-09. Since having 12 schools in 2010-11, MERF has grown from 2,608 students to 3,687 students in 2012-13 to an anticipated 4,087 students for 2013-14, representing growth of 57% over three years.

In addition, MERF has achieved overall ADA rates of 96% for 2011-12 and 2012-13 (based on P-2 reports), respectively. For the twelve schools currently in operation and the projected opening of three more schools, MERF is projecting the following enrollment growth: 4,087 students for 2013-14 (11% growth from prior year), 7,064 for 2014-15 (73% 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 132% growth from current year).

As previously noted, MERF anticipates substantial enrollment growth from 2013-14 to 2014-15, with enrollment projected to increase to 7,064 from 4,087. MERF’s financial soundness review in March 2012 also indicated aggressive enrollment assumptions with MERF reaching 7,064 students in 2014-15. However, the previous enrollment assumptions indicated a more gradual increase in enrollment with MERF schools having reached 5,718 students by 2013-14. MERF has not increased enrollment consistent with previously presented projected enrollment assumptions.

Conversely, MERF has provided Staff with information supporting the current enrollment projections such as multiple MERF schools anticipate moving into larger facilities in high demand areas in the near future. In Section “Projected Debt Service Coverage of CSFP Payments”, we provide an analysis that estimates the amount of student enrollment necessary for MERF to maintain the minimum debt service coverage requirement of 100% in 2016-17 and 2017-18.

With respect to the year-to-year retention rates for the most recent year, three of the twelve schools with returning students showed retention rates of 90% or more, and seven of the twelve schools showed retention rates of 85% or more, with all rates averaging 84%.

Year to Year Rentention Rates						
School	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
MSA-1	73%	83%	90%	99%	93%	84%
MSA-2		87%	74%	90%	86%	91%
MSA-3			68%	81%	78%	70%
MSA-4			85%	74%	83%	85%
MSA-5			63%	75%	79%	70%
MSA-6				97%	81%	82%
MSA-7					86%	88%
MSA-8					92%	95%
MSA-SD	84%	76%	91%	93%	72%	98%
MSA-SC					90%	85%
PTS-SA				95%	95%	70%
PTS-Orange				100%	100%	85%

In response to staff’s request for an explanation regarding the relatively the low retention rates for certain schools (3 schools had retention rates of 70%), MERF provided the following explanation:

1. MSA-5: The school moved to another location in the summer of 2012. MERF expects higher retention rates in 2013-14.
2. MSA-3: Staff turnover is seen as the cause for the lower retention in 2012-13. The school’s administration is paying special attention to maintaining staff going forward.
3. PTS-SA: The current facility is now at a temporary location. MERF expects retention rates to increase when the school moves into a new campus.

Notwithstanding MERF’s less than optimal year-to-year retention rates, overall, staff considers MERF’s consistent enrollment growth to be supportive of a recommendation for financial soundness.

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 2009-10 through 2011-12; (2) MERF’s unaudited financials for 2012-13 (3) MERF’s financial projections for 2013-14 through 2017-18; and (4) MERF’s current enrollment for 2012-13 as well as projected enrollment for 2013-14 through 2017-18.

MERF’s financial projections are based upon the following assumptions: (1) occupancy of the constructed CSFP project in 2015-16 for MSA-SD; (2) increases in enrollment as described above

under the “MERF Enrollment and Retention Rates” section; (3) Conservative 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 97%, which is consistent with MERF’s historical performance; (5) revenue growth (cost of living adjustments) on charter school block grant of 0% for 2013-14 and 2014-15, and 2.0% for 2015-16 through 2017-18; (6) cost of living adjustments for the expense categories are 2.0% for 2013-14 through 2017-18; (7) and maintaining student to teacher ratios of at least 17.25 to 1.

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 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 2010-11	Actual FY 2011-12	Unaudited FY 2012-13	Projected FY 2013-14	Projected FY 2014-15	Projected FY2015-16	Projected FY2016-17	Projected FY2017-18
ENROLLMENT PROJECTIONS								
Enrollment	2,608	3,076	3,687	4,087	7,064	7,913	8,392	8,542
Average Daily Attendance	2,505	2,965	3,539	3,964	6,852	7,676	8,140	8,286
Average Daily Attendance (%)	96%	96%	96%	97%	97%	97%	97%	97%
FINANCIAL PROJECTIONS								
Total Revenues Available for CSFP Lease Payment	\$20,865,544	\$24,631,389	\$27,281,907	\$32,987,486	\$56,460,982	\$64,577,099	\$69,724,566	\$72,657,750
Total Expenses Paid Before CSFP Lease Payment	20,557,865	25,702,559	25,647,823	31,524,449	52,621,229	54,790,921	59,037,242	62,174,584
Accounting Adjustments	169,099	178,343	-	679,000	847,000	510,000	679,000	847,000
Net Revenues Available for CSFP Lease Payment	\$476,778	\$(892,827)	\$1,634,084	\$2,142,037	\$4,686,753	\$10,296,178	\$11,366,323	\$11,330,167
CSFP Lease Payment	\$-	\$-	\$-	\$-	\$-	\$-	\$456,547	\$456,547
Net Revenues After CSFP Lease Payment	\$476,778	\$(892,827)	\$1,634,084	\$2,142,037	\$4,686,753	\$10,296,178	\$10,909,776	\$10,873,620
FINANCIAL INDICATORS								
Net Revenues Available for CSFP Lease Payment	\$476,778	\$(892,827)	\$1,634,084	\$2,142,037	\$4,686,753	\$10,296,178	\$11,366,323	\$11,330,167
Debt Service Coverage by Net Revenues	N/A	N/A	N/A	N/A	N/A	N/A	2489.6%	2481.7%
Contributions	\$51,917	\$406,491	\$523,500	\$468,211	\$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	2329.4%	2317.2%
CSFP Lease Payment / Revenues	N/A	N/A	N/A	N/A	N/A	N/A	0.7%	0.6%
Contributions / Revenues	0.2%	1.7%	1.9%	1.4%	1.1%	1.1%	1.0%	1.0%
Net Revenues After CSFP Lease Payment / Revenues	2.3%	-3.6%	6.0%	6.5%	8.3%	15.9%	15.6%	15.0%
Revenues / ADA	\$8,330	\$8,307	\$7,709	\$8,321	\$8,240	\$8,413	\$8,565	\$8,769
Expenses / ADA	\$8,207	\$8,669	\$7,247	\$7,952	\$7,680	\$7,138	\$7,309	\$7,559
Surplus (Deficit) / ADA	\$123	\$(361)	\$462	\$369	\$560	\$1,275	\$1,257	\$1,210
Net Working Capital	\$1,945,533	\$2,652,551						
Net Working Capital / Expenses	9.5%	10.3%						

Contributions: MERF’s contributions over the last three years were as follows: \$57,565 for 2009-10, \$51,917 for 2010-11, \$406,491 for 2011-12, and \$523,500 estimated for 2012-13. MERF anticipates notably higher contributions in budgeted and projected years, averaging \$700,000 in contributions annually. Staff notes that projected contribution levels are optimistic given the historical trend.

Long-Term Liabilities: At June 30, 2012, MERF had outstanding total debt liabilities of \$7.4 million, of which \$2.3 million were long-term liabilities. These debt obligations took the forms of eight California Department of Education loans totaling \$547,330, and with interest rates ranging from .53% to 1.57%; 10 short-term cash flow loans, totaling \$4.0 million (Repaid in August 2012); Line of Credit, totaling \$749,698 (Repaid in December 2012), and \$2.0 million in CSFP obligations. Of these liabilities, \$5.0 million was due prior to June 30, 2013.

School Facilities – MERF anticipates operating 14 charter schools with a projected enrollment of 8,542 students by 2017-18. 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 - \$388,766, and MSA-SD - \$67,781.

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 were \$472,967 in 2012-13.

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: \$2.4 million (2013-14), \$4.4 million (2014-15), \$5.0 million (2015-16), \$5.2 million (2016-17), and \$5.4 million (2017-18). These estimated expenses are equivalent to an average of 8% 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.

Magnolia Educational & Research Foundation - Projected Facilities Cost					
School	2013-14	2014-15	2015-16	2016-17	2017-18
MERF	\$62,500	\$62,500	\$62,500	\$62,500	\$62,500
MSA-1	\$475,000	\$515,000	\$535,000	\$545,000	\$545,000
MSA-2	\$125,000	\$150,000	\$200,000	\$250,000	\$250,000
MSA-3	\$218,000	\$450,000	\$450,000	\$450,000	\$450,000
MSA-4	\$117,000	\$400,000	\$450,000	\$450,000	\$450,000
MSA-5	\$122,000	\$330,000	\$450,000	\$450,000	\$450,000
MSA-6	\$104,500	\$450,000	\$450,000	\$450,000	\$450,000
MSA-7	\$241,000	\$540,000	\$600,000	\$600,000	\$600,000
MSA-8	\$240,000	\$260,000	\$260,000	\$260,000	\$260,000
MSA-SD	\$60,000	\$60,000	\$0	\$127,781	\$127,781
MSA-SC	\$466,600	\$480,600	\$500,000	\$513,000	\$526,000
PTS-SA	\$198,000	\$0	\$388,766	\$388,766	\$388,766
Proj. 1	\$0	\$350,000	\$350,000	\$350,000	\$375,000
Proj. 2	\$0	\$350,000	\$350,000	\$350,000	\$350,000
Proj. 3	\$0	\$0	\$0	\$0	\$112,500
Total	\$2,429,600	\$4,398,100	\$5,046,266	\$5,247,047	\$5,397,547

MSA-SD facility cost in 2016-17 and 2017-18 includes projected CSFP payment of \$67,781 and current Prop 39 facility cost of \$60,000.

Based on the audited financial statements for 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. In 2011-12, revenues and expenses of \$24.6 million and \$25.7 million resulted in a net loss of \$1.1 million. According to unaudited financials from 2012-13, MERF produced net income of \$1.6 million based on revenues of \$27.3 million and expenses of \$25.6 million.

With enrollment expecting to grow by 11% to 4,087 students next year (2013-14), MERF projects increasing total revenues to \$33.0 million and adjusted expenses to \$30.9 million, for projected net income of \$2.1 million. MERF projects the largest enrollment increase in 2014-15, as enrollment is

projected to increase to 7,064 students. MERF expects net income of \$4.7 million on \$56.5 million in revenues and \$51.8 million in adjusted expenses. For 2015-16, MERF's projected enrollment growth is expected to continue to 7,913 students, resulting in net income of \$10.3 million after accounting adjustments for capital outlay. With 8,392 students expected for 2016-17, total revenues of \$69.7 million would exceed total adjusted expenses of \$58.4 million by \$11.4 million, prior to the projected CSFP lease payments. For 2017-18, student enrollment is projected to increase to 8,542, with total revenues of \$72.7 million and adjusted expenses of \$61.3 million. MERF would have approximately \$11.3 million in net income available to pay the CSFP obligations.

Projected Debt Service Coverage of CSFP Payments: Assuming a 2.0% 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 \$456,547 beginning in 2016-17. MERF's projected net revenues of \$11.4 million for 2016-17 would provide debt service coverage of 2,490%, while the projected net revenues of \$11.3 million would result in debt service coverage of 2,482% 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 and projected schools (8,542 students by 2017-18; 132% growth from 3,687 students in 2012-13).

Staff estimates that MERF would need to enroll at least 5,500 students by 2016-17 to meet the debt service coverage requirement. MERF could potentially maintain at least 100% debt service coverage on CSFP obligations with substantially less enrollment because MERF can modify certain expense categories (i.e. certified and classified salaries) depending on the actual enrollment in a given year. Given MERF's historical enrollment growth, Staff anticipates MERF reaching enrollment in excess of 5,500 by 2016-17. The estimated enrollment needed assumes that MERF maintains a student to teacher ratio of at least 17.25 to 1.

Liquidity: At June 30, 2012, MERF reported holding \$4.94 million in cash and cash equivalents. Liquidity measured in terms of net working capital (NWC) is calculated by subtracting current liabilities from current assets. MERF's NWC for 2010-11 and 2011-12 was \$1.95 million and \$2.65 million, respectively, or 9.5%, and 10.3% of total expenses for these years. Staff considers NWC equivalent of at least 5.0% of total expenses to be sufficient. The NWC in 2011-12 is sufficiently higher than the 5% staff recommendation.

Strengths, Weaknesses and Mitigants

- + MERF's projected debt service coverage ratios of 2,490% in 2016-17 and 2,482% in 2017-18 exceed the minimum requirement of 100.0% by a wide margin. However, Staff estimates that MERF would need to enroll at least 5,500 students by 2016-17 to meet the debt service coverage requirement. Given MERF's historical enrollment growth, Staff anticipates MERF reaching enrollment in excess of 5,500 by 2016-17.
- + MERF has achieved enrollment growth from 188 students at one school (MSA-1) in 2002-03 to 695 students at three schools in 2007-08 to its current 3,687 students at twelve schools. In addition, MERF achieved an aggregate ADA rate of 96% between 2007-08 and 2012-13.
- MERF's ability to produce its projected debt service coverage ratios is heavily reliant on the aggressive enrollment growth projected for its existing schools and projected new schools.
- + 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, all AYP criteria has not been consistently met for the MERF schools. Staff will continue to monitor the AYP scores and all testing data for MERF schools in the future.

Staff Recommendations: Staff recommends that the California School Finance Authority (CSFA) Board 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.