

FCMAT

FISCAL CRISIS & MANAGEMENT
ASSISTANCE TEAM

March 11, 2021

Tony Thurmond
State Superintendent of Public Instruction
California Department of Education
1430 N Street
Sacramento, CA 95814-5901

Brooks Allen
Executive Director, State Board of Education
1430 N Street, Room 5111
Sacramento, CA 95814-5901

Dear Superintendent Thurmond and Executive Director Allen:

This letter is prepared pursuant to a request from California Department of Education (CDE) staff to analyze debt levels for the Ross Valley Charter School (RVC) in Marin County. For purposes of this review, the Fiscal Crisis and Management Assistance Team (FCMAT) engaged with RVC staff, CDE staff and Marin County Office of Education staff.

Finding

FCMAT found the financial information and the answers to numerous questions to be reasonable. FCMAT did not identify any information that would be cause for the State Board of Education (SBE) to deny the petition for renewal based on levels or purpose of debt.

Background

RVC serves 203 pupils in transitional kindergarten (TK) through grade five at a private leased facility located at 102 Marinda Drive, Fairfax. The charter's renewal petition states that RVC plans to enroll 222 pupils each year through 2025-26; this is based on a TK enrollment of 40 pupils each year.

The RVC mission is to provide a public school option that leverages a progressive education model emphasizing deep inquiry and exploration; hands-on, immersion-based experiences; and active learn-by-doing approaches to prepare pupils to collaborate effectively in teams, think critically, seek information to solve problems, and be lifelong learners and culturally competent members of their diverse global community.

RVC is seeking a renewal of its charter from the SBE. On November 10, 2020, the Ross Valley Elementary School District denied the RVC petition by a vote of five to zero. Among other reasons for the denial, the district stated that RVC's debt level was excessive. The petitioner submitted the RVC renewal petition on appeal to the SBE on November 30, 2020. CDE staff have completed their review of documentation provid-

ed by RVC and recommend renewal of the charter with the Marin County Office of Education serving as the authorizing entity. The matter is pending final determination by the SBE on March 17, 2021.

Existing Debt Analysis

RVC existing debt totals \$435,653 as of March 10, 2021, which includes amounts from two loan types. The first is a collection of personal loans provided by supporters of RVC; the second is a facilities construction loan provided by Pacific Charter School Development.

Existing Debt as of March 10, 2021	Current Balance	Annual Interest Rate	Start Date	Maturity
Personal Loans (9)	\$48,500.00	1.50%	7/2015	6/30/2021
Personal Loans (2)	\$50,000.00	1.50%	5/2017	6/30/2021
Pacific Charter School Development	\$337,153.00	2.00%	11/1/20	6/30/2024
	\$435,653.00			

Personal Loans

Supporters of Ross Valley Charter provided these unsecured loans as seed funds for the proposed charter and to establish working capital. There are 11 outstanding loans with balances ranging between \$1,000 and \$40,000. Interest is paid at 1.5%. The initial loans established in 2015 had a four-year maturity date. In 2019, nine loans remained and were extended for two additional years, moving the maturity date to June 30, 2021. Two new personal loans were established in 2019 with a two-year maturity due on June 30, 2021.

Among the outstanding personal loans, none are from board members (although current board members had previously loaned the charter funds and have either been paid in full or the loan has been converted to a donation). The accumulated interest of \$5,400 will be paid when the outstanding loan balances are paid off in June 2021. This interest expense is budgeted and accounted for in the long-term debt object code 7438 on the charter’s first interim report.

The source of outstanding personal loans is not of concern. Charter schools may borrow from any legal source. Loans from families and community members to provide seed funds for a startup charter school are not uncommon. The key concerns are that personal loans are fully documented (all loan terms, even if non-interest bearing), disclosed properly, and do not violate any self-dealing laws. The loan documents provided by RVC demonstrated proper documentation.

Pacific Charter School Development, Inc.

This unsecured loan was obtained to make leasehold improvements of fire alarm and Americans with Disabilities Act enhancements. The lender is also the construction project manager. The original loan balance was \$355,000, with interest charged at 2% of the outstanding balance annually. Draws were taken in accordance with the construction schedule after the RVC contributed \$10,000 as equity in the project. These draws were \$263,046 on November 5, 2020 and \$91,954 on February 26, 2021. An interest only payment of \$380 was required through December 1, 2020. Principal and interest payments began monthly thereafter, varying from \$4,300 to \$6,700 per month. This interest expense is budgeted and accounted for in the long-term debt object code 7438 on the charter’s first interim report.

The loan contains covenants relating to debt ratios. Compliance will be measured annually on June 30 as part of the financial audit. The covenants are discussed in more detail later in this letter under debt ratios.

Prior Debt Paid Off or Forgiven in 2020-21

During the 2020-21 fiscal year to date, RVC paid off or had debt forgiven of \$338,153. The loans that were forgiven or paid off consisted of a federal Payroll Protection Program (PPP) loan, one of the personal loans and an unsecured charter school revolving loan.

Payroll Protection Program Loan

In May 2020, RVC applied for and received a \$270,653 federal PPP loan through the Small Business Administration as part of the federal Coronavirus Aid, Relief, and Economic Security (CARES) Act economic stimulus and pandemic relief efforts. On January 15, 2021, the charter was notified by Westamerica Bank that the full amount of principal and interest was forgiven, and the charter converted the loan liability to income.

Personal Loan

In March 2021, the charter paid off a personal loan of \$5,000. This brought the balance of all personal loans to the charter from \$103,500 to \$98,500. The remaining balance of these loans, as mentioned above, is due and payable as of June 30, 2021.

California School Finance Authority

On June 19, 2017, RVC received an unsecured revolving loan from the California School Finance Authority (CSFA) for startup charters. The original loan amount was for \$250,000 and had an interest rate of 0.98%. Interest of \$439.50 was budgeted at first interim 2020-21 in object 7438. All payments were made by State Controller's Office (SCO) intercept. The final payment was made in March 2021, as confirmed by the CSFA.

Potential New Debt

Charter Asset Management Fund

On January 29, 2021, RVC entered into an agreement to factor principal apportionments receivable with Charter Asset Management Fund. The primary purpose of this debt instrument is to mitigate cash flow issues caused by state-imposed apportionment deferrals experienced by nearly all districts and charters in the 2020-21 fiscal year. The funding schedule reflects that the RVC is eligible for \$300,000 on June 1, 2021, and an additional \$100,000 on July 1, 2021. The interest rate is 5.5%. The repayments are scheduled pursuant to the state apportionment deferral payments July through November 2021. The authorized amount is \$406,987 including cost of capital.

Estimated interest on the factoring is budgeted in object 5852 in the 2020-21 first interim report.

During discussions with RVC, management stated that they chose to factor receivables instead of participating in the CSFA-sponsored charter Advances on State Aid Payments Program because of the flexibility and lower overall cost associated with the factoring option. Depending on timing of receipt of other cash inflows from the recently passed Assembly Bill 86 (Chapter 10/2021), RVC may not need to fund the full amounts allowed.

While factoring receivables is a common occurrence in the charter environment, RVC has not participated in this form of debt financing in the past, nor does it intend to do so in the future.

Accounting and Financial Reporting Standards and Process

The financial reporting standards for most charter schools are not the same as the financial reporting standards used in a school district. School districts (and charter schools that are a component entity of the school district) are governmental agencies and adhere to the national accounting and financial standards of

the Governmental Accounting Standards Board (GASB). Under GASB, school districts and charter schools using this standard typically operate under the modified accrual basis of accounting. On the other hand, charter schools that are organized under a nonprofit organization adhere to the standards of the Financial Accounting Standards Board (FASB). Charters organized under a nonprofit public benefit corporation are most likely operating under a full accrual basis of accounting. Both the reporting standard, GASB or FASB, and the basis of accounting from which the financial statements are prepared, modified accrual or full accrual, may materially affect the overall presentation of the financial statements. These standards are typically defined in the charter school's audit report and often in the charter petition. Most charter schools are organized as or under a nonprofit public benefit corporation, also known as a 501(c)(3) exempt organization, and operate under the FASB reporting pronouncements and standards. This is the case for RVC.

RVC maintains and reports financial data consistent with FASB standards for nonprofit public benefit corporations. This is affirmed in note #1 to the school's annual financial statements and supplementary information (also referred to as an audit report.) For example, RVC maintains a statement of financial position (balance sheet) as compared to a statement of net position for a school district. Likewise, the handling of proceeds from debt and repayment of loan principal is different in a nonprofit organization than it is in a governmental entity.

Nonprofit charter school financial reporting should take into consideration all three FASB reporting model financial statements: statement of financial position (balance sheet), statement of activities (income statement), and statement of cash flows. These three statements should be read together. Debt will be evidenced in the balance sheet as a liability for the outstanding principal balance as of the date of the financial statement. As debt is paid off each year, the liability will decrease, and as debt is acquired, the liability will increase. This means that as debt is incurred, the proceeds of such debt will not be recorded as income or revenue in the income statement, but as a liability in the balance sheet. The notes to the financial statement should describe the debt and its reduction or increase. The income statement will identify the interest expense component of the debt. The statement of cash flow will portray the usage of cash for payments of debt, and will show the proceeds or increases in cash when debt is acquired. All of these standards are evidenced in RVC's financial statements.

The standards under which a school district or charter school prepares its financial statements are further defined in the SCO's Desk Review Checklist for K-12 local education entities. The desk review checklist states, "The objective of this review is to ensure that the audit report meets applicable professional reporting standards ..." Checklist section Basic Financial Statements for Charter Schools Identified as Not-for-Profit Entities, items 26-28, describes the statement of financial position, statement of activities, and statement of cash flows under FASB Accounting Standards Codification (ASC) 958-205-45-4 standards for financial reporting. These standards may also contribute to how the charter school forecasts and presents its debt service analysis, such as future debt service payments allocated between principal and interest in the balance sheet and income statement respectively, and total cash payments in the statement of cash flow.

RVC utilizes a back-office provider company to perform essentially all of its day-to-day business functions. This provider is well versed in the accounting and financial reporting associated with charter schools. Additionally, RVC has a volunteer chief business officer who serves the charter school with high level business executive experience.

Those reviewing the financial statements and observing the accounting treatment in a nonprofit charter need to understand the difference in national standards and the applicability of those differences in day-to-day accounting.

Debt Ratios for Charter Schools

Various types of debt ratios may be applicable to school organizations. For traditional school districts, FCMAT commonly evaluates any non-voter approved debt since often such debt is serviced by the district’s general fund. The ratio utilized in that analysis is total annual debt service payments compared to unrestricted general fund revenue, and a ratio no greater than 2% is acceptable. A district has the option of having voter approved or non-voter approved debt, with the voter approved debt covered by a general tax levy on property values, or a parcel tax based on a fixed amount per parcel. With few exceptions, for a charter school, all debt is non-voter approved.

In its fiscal health risk analysis for charter schools, FCMAT utilizes the same ratio standard of annual debt service compared to unrestricted general fund revenue. The only ratios currently applicable would be fiscal year ending June 30, 2020; however, for this analysis, FCMAT used pro forma data to estimate the ratio as of June 30, 2021.

	2019-20	2020-21
Annual Debt Service	\$62,500	\$171,832
Unrestricted Revenue	\$2,167,945	\$2,047,210
Ratio	.03	.08
Status	Exceeds	Exceeds

The above debt ratio excludes the anticipated factoring in June 2021 as factoring has not been the history of this charter and is only being conducted as a result of the state imposed apportionment deferrals. RVC does not qualify for Senate Bill 740 charter school facilities funding and does not receive any contribution toward its facilities under Proposition 39 (2000) from the district where the charter is located. Additionally, in 2020-21 the charter has a balloon debt payment of \$103,500 associated with the personal loans. This balloon concentrates a large portion of annual debt service in one year (as opposed to the four or two year loan terms). These circumstances contribute to a ratio in excess of the FCMAT standard. In isolation, FCMAT does not believe this indicates fiscal distress or an inability of the charter to service the debt, which ultimately is a determinant factor of fiscal distress.

No specific industry or financial standards limit debt or impose certain debt ratios on charter schools. Financing companies serving the charter school industry evaluate a variety of debt ratios when considering the credit worthiness of a charter school before loaning funds. Relevant to RVC is a set of debt ratios established in its covenants with Pacific Charter School Development, Inc. (Pacific) regarding a \$355,000 construction loan. At article 8, Affirmative Covenants, RVC agreed to maintain the following covenants and ratios computed annually from the school’s audited annual financial statements. The only ratios currently applicable are those from fiscal year ending June 30, 2020.

“Quick Ratio” defined by Pacific as not less than 1.00:1.00, determined by dividing (A) the sum of the charter’s cash, cash equivalents, marketable securities and accounts receivable by (B) the sum of its current liabilities.

	2019-20
(A) Current Assets	\$691,103
(B) Current Liabilities	\$241,435
Ratio	2.86
Status	Met

“Current Ratio” defined by Pacific as not less than 1.05:1.00, determined by dividing (C) the sum of all current assets by (D) the sum of its current liabilities.

	2019-20
(C) Current Assets	\$733,581
(D) Current Liabilities	\$241,435
Ratio	3.04
Status	Met

“Debt to Net Assets” defined by Pacific as shall not exceed 3.50:1.00, determined by dividing (E) the sum of all debts by (F) net assets.

	2019-20
(E) Debts	\$536,166
(F) Net Assets	\$248,997
Ratio	2.15
Status	Met

“Lease Coverage Ratio” defined by Pacific as not less than 1.15:1.00, determined by dividing (G) net income before interest, rent, depreciation, and amortization by (H) the sum of borrower’s current payment obligations under the construction loan, current portion of long term debt and interest expense.

	2019-20
(G) Adjusted Net Income	\$200,361
(H) Current Obligations	\$167,050
Ratio	1.20
Status	Met

Conclusion

Ross Valley Charter is not unlike many small charter schools in the state. The debt incurred by the charter, both in level and purpose, is not out of the ordinary, nor is it excessive. The school has managed its finances in its first five year term without deficiencies, and without the advantages that many other charter schools have through facility options, grants and revolving fund options related to school facilities.

The charter estimates that the debt balance at the end of this fiscal year will be \$613,831. It is of note that all the debt existing at the beginning of the 2020-21 fiscal year was paid in full or forgiven. Only the new debt associated with the construction loan and state-imposed apportionment deferrals is projected to exist at the end of the fiscal year. Absent state-imposed apportionment deferrals, the charter would only have long-term debt associated with facility life safety and path of travel improvements. The table below summarizes the beginning and ending debt balances for 2020-21.

While no standards exist for debt ratios in California charter schools, the debt level and ability of the charter school to service the debt do not appear to be problematic using debt ratios that are common to school districts or that are imposed on RVC as a result of covenants it has made with a lender.

Debt Balance Analysis Fiscal Year 2020-21

	Beginning Balance	Ending Balance
Personal Loans	\$98,500.00	\$0
Pacific Charter School Development	\$0	\$313,831.00
Payroll Protection Loan	\$270,653.00	\$0
CSFA - Charter School Revolving Loan	\$62,932.00	\$0
Charter Asset Management Factoring	\$0	\$300,000.00
Total Debt	\$432,085.00	\$613,831.00

In FCMAT’s limited interaction with the volunteer chief business officer, he demonstrated strong knowledge of the details and accounting methodologies, was able to communicate relevant information clearly and concisely, anticipated FCMAT’s questions and answered them completely and with confidence, and provided documents and other backup immediately upon request (if not before). The volunteer chief business official understands the accounting standards applicable to a nonprofit organization and assists the board and officers in their governance role.

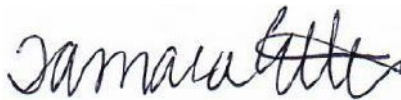
FCMAT’s review was specific to levels and purpose of debt. The review was not an audit of RVC. FCMAT found the financial information and the answers to numerous questions to be reasonable. FCMAT did not identify any information that would be cause for the SBE to deny the petition for renewal based on levels or purpose of debt.

Thank you for allowing FCMAT to assist with this matter.

Sincerely,



Michael H. Fine
Chief Executive Officer



Tamara Ethier
Intervention Specialist