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Prop 30 Passed! Now What?

Finding the Right Solution for your School to Survive the 2012-2013 Cash Flow Drought

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While California's economy has improved over the last year, growth continues to be slow and the state's budget challenges have made times even tougher for charter schools. The legislature passed this year's budget anticipating the passage of Proposition 30, a tax measure that would help balance the budget by increasing income and sales tax. The legislature's optimism proved correct and Proposition 30 passed, eliminating automatic trigger cuts to funding rates that would have put them below last year's rates. That's the good news, especially to Paul Bentz, Executive Director of Community Learning Center Schools in Alameda, a non-profit charter school management corporation that manages two schools, ***Alameda Community Learning Center*** and ***Nea Community Learning Center***: "For our schools, the passage of Prop 30 means not having to make $132,000 in cuts for ACLC and $232,000 in cuts for Nea. Yes, we are very relieved. We had already planned for most of these cuts, and are planning on banking most of the money to improve reserves. [These funds] provide us a buffer for possible additional expenses to move one of our schools to a new location next year, and to delay interest expenses on using our line-of-credit. But, it does create cash flow problems, so we are seeking to expand our line-of-credit to deal with this delay in receiving funds."

As noted by Mr. Bentz, the passage of Prop 30 does create issues from a cash flow perspective, since the state has increased the amount of revenue deferred to schools, with the current fiscal year experiencing the most severe deferrals that charters have ever seen. These deferrals affect all schools – small and large, new and old, urban and rural, charter and district. With state revenues delayed several months and into future fiscal years, charters must dip into reserves to cover ongoing expenses. If cash reserves are not sufficient, charters must take on the additional cost of borrowing to cover expenses while waiting on state payments.

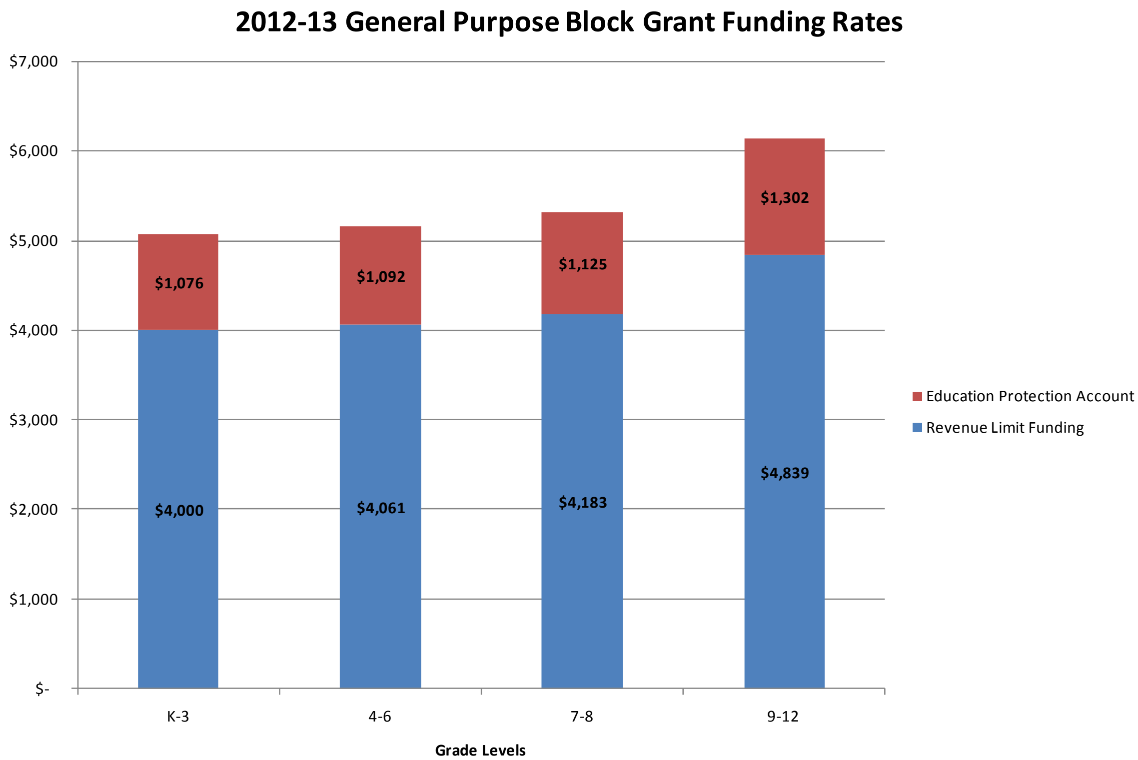
2012-2013 Deferral Situation

The Schools and Public Safety Protection Act of 2012. Earlier this month, California voters approved Proposition 30 ("The Schools and Public Safety Protection Act of 2012") by a margin of 53.9% to 46.1%. Passage of Proposition 30 will raise personal income tax rate for seven years for those earning over $250,000, beginning in the 2012 tax year, and increase sales tax by one-quarter of one percent (0.25%) for four years, effective January 1, 2013. Some of the revenue from the sales tax and personal income tax increases will be deposited into a newly created state fund, the Education Protection Account (EPA).

For 2012-13, the impact of the increased revenue is estimated to keep General Purpose funding in line with last year's funding rate, as shown in the table below.[1]

	2011-12	2012-13		
	Revevnue Limit	**Education Protection Account**	**Revenue Limit**	**Total Funding**
K-3	$5,076	$1,076	$4,000	$5,076
4-6	$5,153	$1,092	$4,061	$5,153
7-8	$5,308	$1,125	$4,183	$5,308
9-12	$6,141	$1,302	$4,839	$6,141

As illustrated in the chart below, funding from the EPA accounts for approximately 21% of General Purpose funding to charter schools, with the remainder made up of revenue limit funding.



Understanding the Deferrals. Beginning in 2003, the state has used deferrals to delay revenue payments owed to schools. Since their implementation, deferrals have consistently increased in both dollar amount and frequency. In 2012-13, schools will be saddled with the largest deferrals ever.

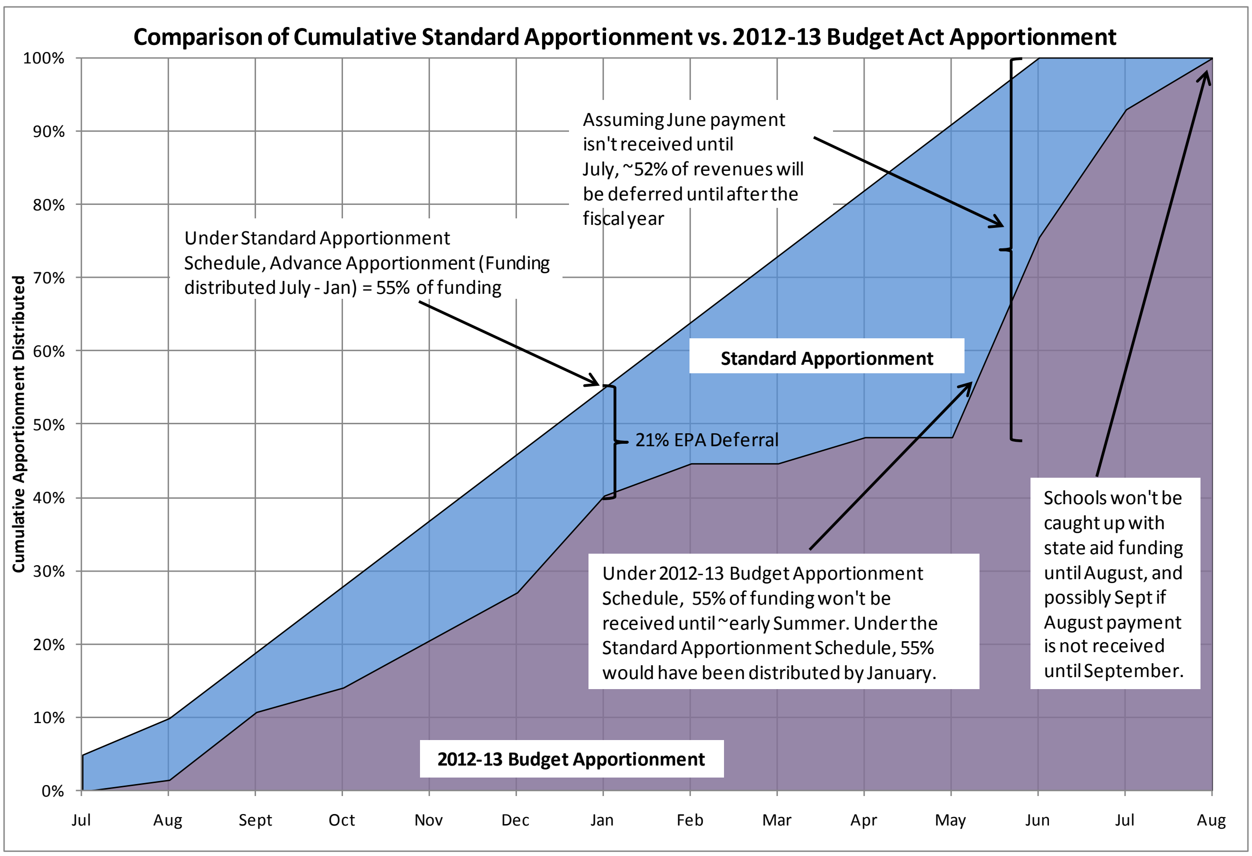
Under the standard apportionment schedule, schools would have received 55% of their funds by January (called the Advance Apportionment). To deal with the uncertainty around the funding rates prior to the November election, the state structured the distribution of the EPA funds to occur in June 2013. This translated to a lower certification of the Advance Apportionment, eliminating an amount equivalent to the funding from the EPA. Additionally, the 2012-13 Budget Act calls for deferrals of all or

[1] Based on the School Services of California 2012-13 First Interim Reporting Period Dartboard.

part of eight different months of payments on the state aid portion of revenue limit funding.[2] As a result, cash flow to schools this fall has been even tighter than in prior years. The graphic below summarizes the monthly standard apportionment and the 2012-13 Budget Act deferral schedule.

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	July	August
State Aid/ - Standard	5.00%	5.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%		
Deferral	(5.00%)	(2.98%)	3.73%	(4.14%)			1.27%	(2.91%)	(3.37%)	(4.18%)	(9.00%)	(9.00%)	2.91%	5.63%
Deferral							2.98%		(5.63%)	(3.25%)			3.25%	4.18%
Deferral							4.14%			3.37%			9.00%	
Deferral													9.00%	
State Aid - Adjusted	0.00%	2.02%	12.73%	4.86%	9.00%	9.00%	17.38%	6.09%	0.00%	4.95%	0.00%	0.00%	24.16%	9.80%
EPA	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	100%		
Property Tax	0.00%	6.00%	12.00%	8.00%	8.00%	8.00%	8.00%	8.00%	14.00%	7.00%	7.00%	7.00%	7.00%	

The chart below illustrates the cumulative funding to charters under the standard apportionment schedule and the apportionment schedule under the Budget Act. No apportionment payment was made in July and charters will be behind in funding throughout the entire fiscal year. In prior years, charters would have caught up with the standard apportionment schedule in January, however, **with the funding from the EPA deferred to June and State Aid deferrals from February through May, charters will see relatively little funding in the spring.**



Meeting Current-Year Obligations. The mismatch between when revenues are received and when expenses are incurred will cause charters real stress as they try to meet current-year obligations. In

[2] Revenue limit funding is comprised of local property tax revenues and money from the state i.e. state aid funding. State aid funding is subject to deferrals while property taxes are not.

many counties, the timing mismatch is further intensified, as there is a lag time for counties to process and send out payments to charters. Charters therefore need to plan to receive these deferred payments as late as 7-21 days after the state distributes the payment. In addition to the deferrals during the fiscal year and assuming that the June apportionment isn't received until July, approximately 52% of the year's total apportionment will be deferred into the next fiscal year, making it very difficult for schools to meet current-year obligations. Although these projections are signed into law, they are subject to change. Keep tabs on the most current information released by the CDE: http://www.cde.ca.gov/fg/aa/pa/pa1213.asp.

What solutions are there to help cope with these deferrals?

At first glance, dealing with deferrals while not compromising the school's financial position or integrity of its education programs can seem like a daunting task. However, there are a number of ways for schools to wait out the deferral schedule while maintaining good cash flow.

In the first volume of *EdTec Connect*, Bryce Fleming's "Bridging the Gap" article provides extensive information, including pros and cons, on options charters can employ to help them get through a cash flow crunch. Any updates or changes to those solutions are addressed below. You can find the article here.

CDE Charter School Revolving Loan Fund. Although it often takes the CDE several months to provide and process applications, thereby resulting in somewhat uncertain timing in receipt of funds, the CDE Revolving Loan Fund remains the best option for capital available to eligible charter schools. As in the past, schools that are still in their first charter term (i.e. before their renewal) can apply for up to $250,000. The loan amount may be lower than $250,000, but schools can apply multiple times if the full $250,000 is not received the first time around.

Traditionally, the application is made available to schools by late summer/early fall, and once approved, schools receive their money a couple of months later. In this environment, the Request for Applications has not yet been released, so schools are currently unable to apply. If approved, schools cannot always expect to get the full award and should plan conservatively. For updates and more information, check the CDE website: http://www.cde.ca.gov/sp/cs/as/csrevloantoc.asp.

Deferral Exemptions. There has been some good news on the deferral exemption front – starting with the June 2013 exemption, the charter authorizer certification will be eliminated, meaning schools will no longer be required to take the potentially risky step of showing their authorizer they would be insolvent without the exemption. However, because this new rule won't be implemented until the June 2013 exemption, the current law still applies to the March 2013 exemption, with the charter authorizer notification requirement intact. Exemptions can be requested from multiple deferrals or from just a single deferral. For 2012-13, charter schools were able to apply for exemptions from the intra-year deferrals (July/August/October 2012 and March 2013). Applications were due in the Spring of 2012. There will be another opportunity, in December, to apply for the March exemption. For updates and more information, check the CDE website: http://www.cde.ca.gov/fg/fi/ir/.

Negotiate with Vendors. Developing strong credit relationships with vendors at the outset of doing business can be critical in times of slow cash flow. Vendors willing to accept purchase orders and negotiate payment terms to coincide with the school's cash flow can be invaluable sources of reprieve when waiting out a deferral. As much as is practical, limit vendor relationships to those that work extensively with public schools, or at least understand their unique financial needs. Engage in honest negotiations with your authorizer regarding payment delays for items such as encroachment or oversight fees. When making promises to pay, be realistic about the timing of funds. Once a promise to pay is made, work hard to meet that deadline. Whenever you are in a tough financial situation, it is always better to be up front about it and work with your partners rather than avoiding creditors' calls.

Bank Loans and Lines of Credit. It is always wise to explore the possibility of a loan or line-of-credit available from the bank with which the school is already doing business. However, not all banks are familiar with the tenuous nature of school finance, so don't be afraid to shop your business to other banks to see if you can get a line of credit. Smaller, local banks may be more willing to work with you.

Private Party Loans. Loans from a private party are not often readily available, but are worth exploring. A private party lender could come from a variety of sources: an authorizer, landlord, vendor or any other partner of the school.

TRANs and RANs. Tax and Revenue Anticipation Notes (TRANs) are short-term, interest-bearing notes that are issued by a district in anticipation of future taxes and other revenues to cover delays for general purpose and categorical funding. Revenue Anticipation Notes (RANs) are essentially TRANs for charter schools. With a RAN, a private investor has the authority to set the total amount of capital raised and the repayment terms. The upside is that due to the presence of a state intercept mechanism, RANs have the ability to fund large amounts at low rates. Since TRANs are only available for large government entities, charters will need to access them though their districts or county offices of education. Also, not all schools are eligible for RANs or have a large enough need to make it cost effective.

An example of a currently offered note program for charters is Citibank's program; more information is available at http://www.charterschoolfunding.org.

Sale of Receivables. Receivables sales have become a widely-available and popular solution for schools based on the low-risk lending from a funder's standpoint, and the quick turnaround time from a charter school standpoint. From the time a school contacts a funder, they can typically receive capital within three weeks if its application is submitted quickly and passes the underwriting process.

If a school is going to do a sale, it's important to think strategically about which receivables to sell and to identify the amount truly needed and for how long. Program fees are typically collected up front based on the total committed amount. So while a lower percentage fee seems like a better deal, it is often not worth it to commit to sell more than a school needs just to secure a lower percentage on the program fee. See the box to the right for an example of how a lower percentage applied to a larger committed amount can lead to higher total costs. A school should remember that if it runs into a cash need in the future, it can simply do another sale then. Schools that

Comparing Program Fees - Which deal is better?

Program Fees are typically collected up front based on the total committed sale amount. The example below compares a receivable sale of \$100,000 with a 5% program fee and another sale of \$1,000,000 with a program feel of 2.5%. Which deal is better?

Deal 1	
Sale Amount	\$100,000
Program Fee Percentage	5.0%
Program Fee Charged	\$5,000
Deal 2	
Sale Amount	\$1,000,000
Program Fee Percentage	2.5%
Program Fee Charged	\$25,000
Difference in Program Fee Costs	**\$20,000**

Deal 1 is the better deal although the program fee percentage is higher!

commit more than they need up front, fail to adjust their budgets to reflect financing costs, or do not maintain expense discipline, are easily forced into a dangerous cycle of depending on the sales to keep afloat.

An example of a receivables purchasing program is the LISC Working Capital Program and more information is available at:
http://www.lisc.org/los_angeles/capital_resources/lisc_working_capital_program.php

What's next?
Even with the passage of Prop 30, charter schools are facing the toughest time in their history, with funding rates near all-time lows and state deferrals larger than ever before. Though it may be daunting to follow the complexities of the deferral schedule, it is critical for school leaders to understand the timing and magnitude of any projected cash deficits and what can be done to proactively manage these shortfalls. At EdTec, we keep up–to-date on the latest deferral schedule so that we can work with schools to anticipate and find solutions well in advance of the school having an actual cash flow need. We ensure that cash flow projections cover a 12-month period and are updated on a monthly basis. If a cash need is identified, start the process early for the financing options that have longer lead times, and remember that in any financing situation, the goal should ultimately be to meet cash flow needs while incurring the lowest cost on an absolute dollar basis.